Why It's in the US Interest to Establish Normal Trade Relations with Russia

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Russia is the world's 10th largest economy but ranks only 37th among US export destinations. Not coincidentally Russia is the last major economy to seek membership in the World Trade Organization (WTO). Once Russia accedes to the WTO, US firms can rely on commitments that Russia pledged in the 2006 US-Russia Bilateral Trade Agreement and subsequent accords—but only if the US Congress votes in favor of granting permanent normal trade relations (PNTR) to Russia.

Congress will likely face this critical vote during 2011. A "yes" vote on PNTR could set a favorable tone for economic relations between the United States and Russia over the next decade and beyond, and would give the global agenda of trade and investment liberalization a fresh boost. A congressional "no" vote would likely have broad adverse consequences, it would send a clear message of US skepticism that the WTO is the right forum for handling US commercial relations with Russia, and it would virtually invite Russia to erect hurdles against US exports.

This study does not attempt to dissect the political dimensions of US-Russian relations; rather it presents an analysis of the current economic picture and the policy implications of PNTR for US firms, Russian economic growth, and bilateral commercial relations. The Institute has a long record of research on major trade initiatives, but prior to this Policy Analysis the Institute did not give the PNTR question and US economic relations with Russia the attention they deserve. This study fills a hole by drawing on the expertise of the authors and their previous work on US trade policy and the Russian economy. The Policy Analysis examines in depth why PNTR is essential for establishing normal commercial ties between Russia and the United States.

The analysis provides estimates on the potential increase in US exports to Russia, and the potential growth of two-way trade within the WTO framework. The authors find that PNTR would deliver significant commercial benefits to the United States in important sectors—agriculture such as pork and poultry, manufactures like aircraft, transportation equipment and pharmaceuticals, high-tech products like software and electronics, and services such as telecommunications, express delivery and insurance. Estimates reported in this Policy Analysis suggest that US exports to Russia could double (from $9 billion

to $19 billion) if US firms enjoy the best terms of access to the Russian market associated with WTO accession. More generally, PNTR will give US firms a stronger legal footing to ensure that Russia observes all the commitments undertaken in its accession to the WTO. Of course US imports from Russia will also rise. The principal US imports from Russia are petroleum, chemicals and base metals; in 2008 US imports of goods and services from Russia totaled $32 billion. US barriers to these imports are already very low and will not be affected by PNTR or WTO accession. However, normalization of bilateral trade relations should give a modest boost to these imports as Russian suppliers become more efficient.

Russia ranks among the wealthiest emerging-market countries, and the Russian market will only grow larger in the future, a fact that US firms cannot ignore. Russia's accession to the WTO and a favorable PNTR vote will provide a stepping stone for the United States and Russia to unlock the potential of their bilateral economic relations.

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Executive Summary

The US congressional vote on extending permanent normal trade relations (PNTR) for Russia could set the tone for economic relations between the United States and Russia for the next decade and beyond. PNTR would permanently establish most favored nation (MFN) trade relations between the United States and Russia. MFN already provides the foundation for US trade relations with virtually all 153 members of the World Trade Organization (WTO). Extending PNTR to Russia entails no special favors or privileges; rather PNTR will accord to Russia the basic treatment enjoyed by the United States' other WTO trading partners on a permanent and unconditional basis.

The 2006 bilateral agreements[1] and follow-up agreements signed by Russia as a prelude to its accession to the WTO contain significant concessions valuable to the United States in intellectual property and market access conditions for several important products: meats, agriculture, biotechnology, harvesters, leased aircraft, and goods with encryption technology. Once Russia accedes to the WTO, the ability of US firms and farmers to permanently take full advantage of these and other commitments that Russia has assumed in connection with its accession will depend on a US congressional vote in favor of PNTR.

If PNTR opponents in the US Congress prevail, Russia might take a narrower and less constructive interpretation of its obligations under the existing bilateral agreements with the United States. A vote against PNTR would require the United States to invoke the non-application provisions of the Marrakesh Agreement which created the WTO. Russia could then deny US firms the benefits, particularly in the services sector, negotiated by the US and other governments in the WTO accession process over the past 17 years. US firms and workers would be placed at a disadvantage in the booming Russian economy, one of the fastest growing import markets in the world today and possibly for years to come.

Some Americans may object to PNTR on foreign policy grounds. In a word, they may want to register disapproval of Prime Minister Vladimir

1. The United States and Russia concluded ten bilateral agreements on products including intellectual property rights (IPRs), pork and poultry, encryption, aircraft, beef, biotechnology, and pork and poultry plant inspections.

Putin, or they may not want to abandon an instrument—the Jackson-Vanik Amendment—that they believe could be used to impose stronger conditionalities on Russia. However, the imposition of Smoot-Hawley tariffs across the board on imports from Russia—which the United States could theoretically levy in the absence of PNTR—is too blunt an instrument for normal diplomatic use. The US government has alternative bilateral and multilateral mechanisms that can be used to engage Russia on human rights questions and political and religious freedoms, such as the US-Russia Bilateral Presidential Commission and the Organization for Security and Cooperation in Europe. If a future president chooses to reinforce diplomacy with economic sanctions, tailored penalties, including draconian measures if necessary, are readily available under other US statutes.

Moreover, by voting "no" on PNTR, the US Congress would be missing a great opportunity to endorse the cause of liberal voices within the Russian government who advocate political and economic engagement with the West. Over the last two years, the US "reset" policy toward Russia has revived US-Russia relations and has already resulted in the ratification of a new bilateral Strategic Arms Reduction Treaty in December 2010 and the Civilian Nuclear Agreement concluded in May 2008. Russia has opened the Northern Delivery Network of Afghanistan and accepted US demands with respect to sanctions on Iran. The establishment of the Bilateral Presidential Commission facilitates a regular exchange of ideas on common interests and concerns. A "no" vote on PNTR would provide fresh arguments to a large group of Russians who believe that the West (and the United States in particular) disdains a "relationship of equals" with Russia and cannot be trusted!

From the standpoint of US economic and political interests, therefore, a "yes" vote on PNTR represents a win-win combination. A "yes" vote on PNTR would deliver the following commercial benefits to the United States:

- PNTR will ensure that the best available conditions of access to the Russian market offered to other foreign firms are also offered to US firms, through both trade and investment in the fast growing Russian economy. Russia is not a "petro-economy" akin to the Middle East, but rather an immense and sophisticated market. Indeed, Russia is currently the tenth largest economy in the world but ranks only 31st among US export destinations.
- WTO accession will require Russia to enact new rules on issues ranging from services regulations to inward foreign investment to agricultural standards to intellectual property. These rules will bring greater certainty for US firms doing business in Russia. Moreover, membership in the WTO requires a country to observe a vast fabric of commercial law. Without PNTR, the United States could not invoke the WTO dispute settlement provisions in the event Russia failed to observe these obligations in its dealings with US firms.
- PNTR, and application of the 2006 WTO Bilateral Market Access Agreement between the United States and Russia, will give US firms a stronger

legal footing to ensure that Russia observes *all* the commitments undertaken in the context of its accession to the WTO. By contrast, failure to approve PNTR and invoking the non-application provisions of the Marrakesh Agreement Establishing the WTO will lead to ad hoc and less satisfactory dispute settlement processes, with the potential for counter-retaliation—in other words a continuation of the current situation that offers us a very poor tool kit today for addressing potential trade problems with Russia.

- Estimates reported in this policy analysis suggest that US exports (goods) to Russia could possibly double (from $9 billion to $19 billion) if US producers enjoy the best terms of access to the Russian market associated with WTO accession. These gains will be realized as the obligations of the agreement are phased in; the gains will be distributed across the board, from agriculture to manufactures to services. Econometric models indicate that new US export opportunities will also flow from an expansion of US foreign direct investment (FDI) in the Russian economy, highlighting the importance of the PNTR vote.
- Rejecting PNTR will penalize US exporters, as they will likely suffer discrimination by comparison with other suppliers to the Russian market.

Possible US gains from Russia's WTO accession and PNTR on a sector-by-sector and state-by-state basis are summarized below. More detail is provided in box ES.1.

Agriculture

Russia is one of the world's top meat importers and has historically been the largest importer of US poultry. Russia's accession to the WTO will help to ensure that Russia's markets remain open and curtail the hassles that US firms confront when they ship beef, pork, or poultry to Russia, particularly with regard to sanitary and phytosanitary (SPS) measures. It will also constrain the room for maneuver by the Russian Ministry of Agriculture to invoke trade restrictions based on SPS considerations that are not anchored on science-based criteria. Russia offers a meaningful market for states with a strong agricultural base, such as Arkansas (poultry), Iowa (beef and pork), and California (wine, fruits, and nuts).

Manufactures

Russia's WTO accession and PNTR will open doors for US manufacturing firms, particularly in high-technology products such as pharmaceuticals and aircraft. Russia relies on foreign manufactures for the majority of its domestic supply of drugs (77 percent) and medical devices (60 percent).[2] US manufacturers

2. See Coalition for US-Russia Trade (2010b).

Box ES.1 Impact on the US economy

- Qualitative gains:
  - Accession will limit Russia from arbitrarily raising tariffs and invoking non-tariff barrier (NTB) protectionist measures in the future. During the Great Recession of 2008–09, Russia jacked up tariffs on numerous manufactured imports (Hufbauer, Kirkegaard, and Wong 2010). Once Russia's tariff schedule is "bound" in the WTO, this sort of arbitrary action will no longer be possible.
  - Moreover WTO accession will put US-Russia commercial relations on a sounder and friendlier commercial footing.
- Quantitative gains:
  - Currently the United States is the destination of only 6 percent of Russian exports and the source of just 4 percent of Russian imports.
  - Between 2005 and 2010 total bilateral trade between the United States and Russia doubled.[1] The next five years should see a similar increase; our own estimates indicate a doubling or more of Russia's external trade following WTO accession, assuming strong Russian economic performance.
  - Given that overall Russian trade is likely to double, WTO accession *alone* should increase Russian bilateral manufactures trade by 20 percent. This would imply an increase of $2 billion in total bilateral manufactures trade with the United States.
  - The associated increase in Russia's inward FDI stock (estimated to be 50 percent) would trigger an increase in total Russian two-way trade in manufactures of about 5 percent. This would imply an increase of $0.5 billion in bilateral manufactures trade with the United States. Good Russian economic performance will further enlarge two-way commerce.
- Russia has committed to binding its applied tariffs on detailed tariff lines. The average weighted bound tariffs will thereby be cut to the following levels:

Sector	**Current average weighted bound tariffs** (percent)	**Post-WTO accession rates** (percent)
Agriculture and food	35	25
Metallurgic products	19	12
Machinery and transportation equipment	15	9
Chemicals	10	6

- Increased market access for US agricultural exports:
  - Russia is the world's second largest import market for beef and pork and has historically been the largest importer of US poultry. Consumer spending on food grew by 70 percent between 2002 and 2008 and is predicted to remain strong.
  - WTO accession will ensure that the United States enjoys the same access to Russian agricultural markets as its leading competitors such as Brazil and the European Union. In the absence of WTO accession, Russia will be free to discriminate against US exports.
  - Revised Russian sanitary and phytosanitary (SPS) regulations will help ensure that any trade restrictions are based on scientific criteria.
  - Under these liberalized conditions, US agricultural exports to Russia are expected to double or triple within a few years of WTO accession.
- Increased opportunities for US industrial exports:
  - Industrial goods already account for 86 percent of US merchandise exports to Russia; however, the US export structure has become more diversified in recent years, with significant increases in exports of aircraft, motor vehicles, and sundry equipment.
  - Tariffs on the sale of civil aircraft will be reduced from 20 percent to single digits; tariffs on civil aircraft parts will drop to an average of 5 percent.
  - Russia is the largest importer of pharmaceuticals among the BRICs (Brazil, Russia, India, and China). Currently, US exports to Russia are only $70 million, a fraction of its pharmaceutical exports to the other BRICs.
  - Russia has agreed to reduce its export duties on steel scrap (an important input for US steel mills) to one-third of their current levels.
- Significant liberalization of banking, finance, and other services:
  - Under WTO accession, Russia will allow 100 percent foreign ownership of banks, securities firms, and nonlife insurance firms.
  - Russia agreed to open its telecommunication services market to all foreign suppliers and allow companies to operate as 100 percent foreign-owned enterprises.

1. Even when oil is excluded from trade, total bilateral trade between the United States and Russia still doubled.

already have a strong position in the Russian market (supplying 25 percent of Russian medical devices and 5 percent of pharmaceuticals), with Pfizer alone exporting $164 million worth in 2008. Upon WTO accession Russian tariffs on imported pharmaceuticals will fall from 15 percent to around 6 percent and tariffs on medical devices will be on around 5 percent, creating much greater

market access for US firm. Robust growth in the Russian economy will benefit US exports of industrial machinery equipment such as tractors, oil and gas field equipment, hydraulic hand tools, and transportation vehicles. Upon WTO accession Russia will cut tariffs on transportation equipment to an average of 8 percent and will allow information technology (IT) imports to enter Russia duty free. Texas, Iowa, and Illinois have already realized gains in exports of specialized machinery to Russia. Russia's development of its natural resources (forestry, agriculture, mining, and energy) will provide additional opportunities for US producers of capital goods.

Industrial States

Since 2001, new export opportunities in "transportation equipment"—covering automobiles, trucks, and spacecraft—have boosted exports not only for such obvious industrial states as Michigan, Ohio, and Wisconsin but also for Washington, Arizona, and Tennessee. Russia's WTO accession and PNTR will improve conditions for direct investment by US auto firms in Russia, as these companies source a large share of their deliveries from the US. This will enable US firms to exports a wide range of parts and components, and to earn investment income on operations in Russia.

High-Technology States

California and Massachusetts have tapped Russian markets in software, computers, and electronic equipment, while Washington state and others have taken advantage of better access for aircraft exports and MS products. Some of the concessions the United States has secured from Russia in its 2006 bilateral agreement with respect to such matters as aircraft tariffs will be sealed only with Russia's WTO accession—and these concessions become operative for US firms only if the US Congress passes PNTR. Others, such as the encryption agreement are fully valid now. Moreover, membership in the WTO on equal terms with Russia would enhance the position of US high-tech exporters and improve conditions for additional investment in Russia.

Services

The United States is very competitive in a wide range of services industries, from finance to education to retailing, and Russia's WTO accession will enable qualified firms to establish a commercial presence through their investment stakes. Russia has agreed to loosen its caps in telecommunications, finance, insurance, express delivery services, and professional services, but PNTR holds the key to enabling US firms to enjoy Russia's market-opening commitments and greater regulatory transparency in these sectors. Services exports are likely to increase *at least* as fast as merchandise trade, and with time, Russia's acces-

sion will likely present new opportunities in other services sectors, such as energy and professional services.

Some worry about possible parallels between PNTR for China and Russia. In fact, their situations are very different. Russia is not likely to become a significant exporter of manufactures for the foreseeable future. As a predominant commodity exporter and a much richer country than China, Russia's cost level is too high. Therefore, American firms with operations in Russia typically buy a large share of their inputs and services from the United States. Unlike China, Russia is already a high-end producer of software with a strong interest in protecting its intellectual property rights (Crane and Usanov 2010). Russia has larger international reserves than it desires and intends to let its current account surplus shrink toward balance, boosting its import demand. The Russian ruble floats relatively freely against other currencies and poses no concern for the sort of severe undervaluation experienced with the Chinese yuan.

This policy analysis deals only with the economic aspects of PNTR for Russia and what it will mean economically for the United States. Naturally, Russia arouses political concerns in the United States, but this is another discussion. We contend that the Jackson-Vanik Amendment provides an unsuitable instrument for handling either political or trade issues.

1

Introduction

In 2011, the US Congress is likely to face a critical vote on granting permanent normal trade relations (PNTR) to Russia in connection with its impending membership in the World Trade Organization (WTO). In the best scenario, this vote will occur in the same time frame that the WTO General Council approves Russia for membership. If Russia joins the WTO without PNTR in sight, the United States would have to invoke nonapplication of the WTO to trade between United States and Russia, a truly unfortunate outcome. PNTR will extend to Russia, on a permanent and unconditional basis, the same tariff treatment that the United States already extends to other WTO members. Much is at stake in the PNTR debate, both in symbolic and practical terms. The congressional vote on PNTR for Russia could set the tone for economic relations between the United States and Russia for the next decade.

Currently the basic agreement for trade between the United States and Russia is the Bilateral Trade Relations Agreement reached in 1991 between the United States and the Soviet Union, providing for mutual extension of most favored nation benefits, now known as normal trading relations. It was adjusted to apply to Russia in 1992 after the Russian Federation was established. This agreement is authorized by Section 405 of Title IV of the Trade Act of 1974, which forms the basis for trade relations between Russia and the United States.

After 13 years of negotiations, on November 19, 2006, Russia reached an extensive bilateral agreement with the United States on market access conditions for its accession to the WTO. Since then, negotiators with the Office of the US Trade Representative (USTR) have engaged their Russian counterparts on implementation of pre-accession commitments agreed to under the 2006 bilateral agreement and have worked on multilateral issues related to WTO accession with other trading partners who are also members of the Working Party on Russia's WTO accession. While the process significantly slowed between 2008 and 2010 due to Russia's war with Georgia in August 2008 and the establishment of the Russia-Kazakhstan-Belarus Customs Union, Presidents Barack Obama and Dmitri Medvedev reenergized Russia's accession bid in June 2010 with a commitment to resolving bilateral issues by September 30, 2010. This led to substantial progress in the negotiations.

Russia's bilateral negotiations with Georgia and the multilateral negotiations have not been completed, and a few other tasks remain. The primary obstacles concern rules for the importation of goods with encrypted technology and related encryption standards; sanitary (animal health) and phytosanitary (plant) rules; protection of intellectual property; demand by numerous working party members that Russia reduce its level of agricultural subsidies; verification of the consolidated market access schedule for goods; and the ongoing, tedious effort to modify the Working Party Report to reflect the rules of the new Customs Union with Kazakhstan and Belarus. Nonetheless, the conclusion of multilateral WTO talks is imminent, and the stage is now set for US congressional consideration of PNTR.

Significance of the Jackson-Vanik Amendment

The Jackson-Vanik Amendment to the US Trade Act of 1974—the law that provides the backdrop for the PNTR debate—was enacted in the midst of the Cold War. It targeted the repressive emigration policies of the Soviet Union and other communist countries. After the demise of the Soviet Union, the law applied to all the former Soviet republics, as well as China, Vietnam, and a few other countries. The Baltic states—Estonia, Latvia, and Lithuania—were exempted, as the United States had never recognized Soviet occupation of these three countries (Pregelj 2005).

In order for Russian exports to enter the US market at normal tariff rates, signifying normal trading relations—until 1998 known as most favored nation status—the US president must either grant an annual "waiver" or issue a semiannual report certifying by June 30 and December 31 of each year that Russia is in compliance with the freedom of emigration provisions in Section 402 of Title IV of the Trade Act of 1974 (more commonly known as the Jackson-Vanik Amendment). The statute specifies that free emigration is necessary for (a) normal trading relations with the United States; (b) access to US government financial facilities; and (c) the ability to conclude a bilateral trade agreement with the United States. On an annual basis, the US Congress has the opportunity to pass a joint resolution of disapproval of a presidential determination of Russia's compliance. The US Congress has not attempted such a resolution. (US-Russia Business Council and AmCham Russia 2005). In the theoretical event of congressional disapproval, imports from Russia would be subject to Smoot-Hawley tariff rates. Since these Depression-era tariffs range up to 50 percent ad valorem, most Russian imports would be excluded from the US market.

Times have changed and the amendment has not been a necessary tool of leverage vis-à-vis Russia for many years. The overt purpose of Jackson-Vanik—free emigration for Russian Jews—has never been in question since Russia became independent in 1991. Russia was originally granted most favored nation status in 1992 under the US-Soviet Bilateral Trade Agreement of 1991. The US president or the secretary of state has issued a waiver of Jackson-Vanik require-

ments or found Russia to be in compliance with the freedom of emigration requirements every year since 1994, and there has been no recorded vote in Congress challenging these decisions. Passage of PNTR thereby, overriding the Jackson-Vanik Amendment with respect to Russia, would be a political statement, symbolizing Russia's treatment as a *normal* country in US trade. Furthermore, it would create a more stable climate for doing business, and most important, be a step towards welcoming Russia into the WTO. Failure to terminate application of the Jackson-Vanik Amendment to Russia has implications that go far beyond the benefits of holding on to a relic of past confrontation. Rather, it would prohibit Russia from receiving unconditional and permanent normal trading relations and would send the message that the United States is unwilling to embrace the transformation of Russia since the days of the Cold War.

Many people seem to be under the mistaken impression that Jackson-Vanik graduation/PNTR is a necessary prerequisite for a country's WTO accession, but that is not the case. Originally, the Jackson-Vanik amendment applied to almost all communist countries. Gradually, they have received first a waiver, then been declared not to be in violation, and finally most have been "graduated," namely Albania, Armenia, Bulgaria, China, Czechoslovakia, Estonia, Georgia, Hungary, Kyrgyzstan, Latvia, Lithuania, Mongolia, Romania, Ukraine, and Vietnam in correspondence with each country's WTO accession. Several countries have joined the WTO without having previously secured PNTR from the United States, notably Mongolia, Kyrgyzstan, Georgia, Moldova, Romania, and Armenia. All but Moldova were subsequently graduated by Congress from the Jackson-Vanik Amendment. Exceptionally, Ukraine, which became a WTO member in 2008, was graduated by Congress in advance of its WTO accession in March 2006. Moldova is the only WTO member still subject to annual determination of "non-violation" of the Jackson-Vanik Amendment.[1] What this means is that the United States extends MFN treatment to Moldova's exports year-by-year and Moldova does likewise for US exports: While the two countries do not apply the body of the WTO law to their trade relations, they have little trade and practically no trade friction. But Russia is no Moldova and would not passively accept a year-by-year extension of normal trade relations with the United States.

Why the United States Should Grant Russia Normal Trading Relations

Subjecting US imports from Russia to tariff levels that dramatically exceed the rates paid by almost all other US trading partners would not ultimately benefit US interests. Smoot-Hawley tariffs would cut off almost all trade; fundamentally, the Jackson-Vanik sledge hammer is too big for sensible use. Unlike

1. The Jackson-Vanik Amendment still applies to Russia, Belarus, Kazakhstan, Tajikistan, Turkmenistan, Uzbekistan, which have not yet joined the WTO.

the International Emergency Economic Powers Act (IEEPA), which authorizes the president to fine tune economic sanctions according to the objective sought, Jackson-Vanik is an all-or-nothing switch. There are very few foreseeable circumstances in which the United States would want to terminate its 1992 Bilateral Agreement on Trade Relations between the United States and Russia and cease all economic contact with Russia, but if those circumstances arose, the president could invoke IEEPA after Jackson-Vanik is retired through PNTR.

Getting the "tone right" in the bilateral relationship will be vital to reaping the full economic benefits of Russia's accession to the WTO. If the US Congress does not vote to grant Russia PNTR, Russian companies will become wary of the United States. And since US companies would be put at a competitive disadvantage in the ensuing atmosphere of distrust, they would be less able to compete for Russian business.

The United States has already received significant concessions through the 2006 bilateral agreement with Russia, but locking in these far-reaching trade benefits for US interests depends on a successful congressional vote to grant PNTR to Russia. In other words, Russia might choose to ignore the terms of the 1992 Bilateral Trade Agreement, even if it formally adhered to it, and Russia would not be obliged to apply the whole fabric of WTO rules to its commercial dealings with the United States. Under Article 35 of the General Agreement on Tariffs and Trade (GATT) (incorporated into the WTO), when a country accedes to the WTO, any existing WTO member can decide not to apply WTO terms to the new member, and vice versa. If the United States does not graduate Russia from the Jackson-Vanik amendment, it would be obliged to invoke non-application. If the United States does not confer PNTR on Russia, but continues to waive Jackson-Vanik one year at a time, it seems likely that Russia will pick and choose among the WTO obligations that it extends to the United States. Two can play the game of conditional trade relations!

Thus, if congressional opponents of PNTR prevail, sales by firms located in the United States might be denied benefits negotiated by the United States and other governments over the past 18 years. In such a case, a retaliatory relationship may ensue, and US workers would lose out. Therefore, a negative vote on PNTR hardly sets the tone for a vibrant commercial relationship with Russia, one of the fastest growing import markets in the world today and possibly for years to come.

Congressional failure to permanently normalize trade relations would likely have broad consequences, since it would send a clear message of US skepticism that the WTO is a suitable forum for handling commercial relations between major powers. By contrast, if PNTR proponents carry the day, both the WTO and the global agenda of trade and investment liberalization will receive a fresh boost, as Russia is the last major economy to join the WTO. Russia's accession would truly make it the *World* Trade Organization.

From the US point of view, granting Russia PNTR is a win-win option. A vote for PNTR will extend to Russia, on a permanent and unconditional basis, the same trade conditions that the United States grants to other signato-

ries of the WTO. In turn, the United States will gain three major economic advantages:

- First, Russia's adoption of rules on issues ranging from trade-related investment measures to intellectual property protection will add greater certainty to the business environment and "lock in" market access concessions. The "locking in" effect constitutes an important benefit for firms as it provides greater predictability and ensures that the market will not become more restrictive in the future. Russia's membership in the WTO does not, by itself, require that Russia extend its WTO obligations to the United States. Instead, WTO members and Russia have the opportunity to declare that WTO rules will not apply between them. If the United States does not grant Russia PNTR, the United States will be required to invoke Article XIII of the Marrakesh Agreement Establishing the WTO ("non-application") or be in breach of its WTO obligations. Instead, by establishing permanent normal trade relations with Russia, the United States can encourage Russia's efforts to strengthen its fragile legal and economic institutions, the weakness of which poses a major risk to Russia's long-term progress.
- Second, a negative vote on PNTR will translate into lost opportunities and put sales from firms in the United States at a disadvantage vis-à-vis competitors. *In the event of a "no" vote, the Russian government will very likely give preference to products and services from other nations.* America's commercial competitors in Europe and Asia are already taking steps to enjoy the fruits of Russia's WTO commitments, some of which were secured by the United States at the negotiating table. In fact, in October 2006, the European Union—a direct US competitor in the Russian market—unveiled a new trade strategy that upgrades Russia to the status of a top priority partner. The strategy document states that Russia has "combinations of market potential and levels of protection which make [the country] of direct interest to the EU" (European Commission 2006). While it is unclear how fast potential EU negotiations with Russia can advance toward a free trade agreement, at the national level individual European countries are already orienting their export promotion machinery to target the Russian market. Rejecting PNTR is hardly the path for the United States to capture the potential benefits of Russia's WTO accession calculated in this policy analysis—a doubling or tripling of US exports to Russia.
- Third, while the 1992 agreement provides certain benefits, without PNTR some US companies will run the risk of meeting obstacles in their effort to establish a commercial presence in Russia. The Russian bureaucracy is perfectly capable of discriminating, for example, between German and US service providers. Moreover, US firms and farmers might not enjoy the nontariff barrier liberalization that undergirds Russia's WTO commitments, and they will be at a disadvantage in challenging adverse measures—e.g., technical barriers to trade and sanitary and phytosanitary

measures—because the United States will not have recourse to the WTO dispute settlement mechanism. Likewise, US firms might not fully enjoy Russia's commitments in key areas such as transparency—which is critical to financial and energy services—or trade facilitation provisions, which are particularly important to the express delivery services industry. To be sure, concluded side letters address many existing irritants, but it would be a mistake to assume that new irritants will not emerge in the future.

In political terms, a vote against PNTR, or no vote at all, means that the US administration—with congressional oversight—will continue its semiannual reviews of Russian policies, holding out the distant threat of terminating the 1992 Bilateral Trade Agreement and imposing Smoot-Hawley tariffs on Russian imports. While distant, the threat would be understood as major discrimination in Moscow, and Russia would act accordingly.

By contrast, approving PNTR would convey the right political tone to the overall tenor of US-Russia relations. In Russia today, liberal and reactionary forces are competing to define the country's political future. Public opinion studies there show an ambiguous attitude toward globalization and international trade. Russia's WTO membership and PNTR for Russia will help anchor Russia in the West and strengthen the liberal and legally oriented forces in Russia. A substantial part of the Russian elite opposes Russia's accession to the WTO. These are people connected with the security services who have little contact with the West and desire even less. If Russia becomes a member of the WTO and has a WTO-compliant trading relationship with the United States, such forces will be dealt a meaningful setback. WTO membership will bring Russia into participation with a substantial body of commercial law (thousands of pages of WTO legal text) and an effective arbitration court (the dispute settlement system of WTO panels and the WTO Appellate Body). Both the WTO and PNTR will help shape Russia's integration into the global economy. While PNTR is mainly a vote to cement US economic access in Russia, it also carries the symbolic significance of US recognition of Russia's economic advances and US intentions to work through commercial differences using the established mechanisms of the WTO.

In sum, the United States gains nothing by postponing the application of PNTR status. Indeed, without PNTR, the United States would be singling out Russia from practically all other WTO members by applying conditional treatment. Russia is on course to becoming a full-fledged member of the WTO, regardless of what Congress decides on PNTR. Given the strong market access terms of the 2006 bilateral agreement that the United States has negotiated to date and the outlines of the 2006 commitments that Russia is working to address, it would make little sense not to take advantage of the full benefits of Russia's WTO accession by granting PNTR to Russia once the final terms are at hand.

2

Russia's Rising Economic Significance

Russia is one of the big, rising economies of the future. In the last two decades, the Russian economy has experienced a dramatic turnaround. Long decline was followed by impressive expansion. There are good reasons to anticipate that Russia's growth will remain strong in the decades ahead. If Russia grows as expected, it will rank among the world's most important export markets, and the United States needs to have a prominent position in that market.[1]

Russia's dramatic economic recovery began in 1999. Until a few years ago, the standard joke was that Russia's GDP was smaller than that of the Netherlands. Between 1999 and 2010, the Russian economy grew by an annual average rate of 6 percent, measured in current US dollars (figure 2.1).[2] However, because of the sharp real appreciation of the ruble, Russian GDP measured in current US dollars expanded by 22 percent a year over the same period, from barely $200 billion in 1999 to $1.5 trillion in 2010. According to the October 2010 International Monetary Fund (IMF) forecast, Russia is now the tenth largest economy in the world, measured by GDP in current dollars ($1.48 trillion), coming just after Canada and before India. If GDP is measured in purchasing power parity, Russia is already the sixth biggest economy in the world, after Germany and India but ahead of Brazil, the United Kingdom, and France.

In a much-noticed paper on the BRICs—Brazil, Russia, India, and China—Goldman Sachs projected that these four economies together are likely to be larger than the combined economies of the G-6 nations in less than 40 years (Wilson and Purushothaman 2003).[3] Although cautiously projecting an average annual growth for Russia of only 3.9 percent, at market exchange rates, Goldman Sachs forecast that Russia's economy would overtake those of Italy

1. Between 2000 and 2008 Russian imports from the world have increased more than sixfold; from $50 billion to $313 billion.

2. Although we use 2010 figures in this figure, we prefer to use 2008, the last normal year before the great global recession, as the reference date rather than 2009, which saw large but temporary declines. As of this writing 2010 statistics are not yet available for all the data covered in this analysis.

3. The G-6 nations are France, Germany, Italy, Japan, the United Kingdom, and the United States.

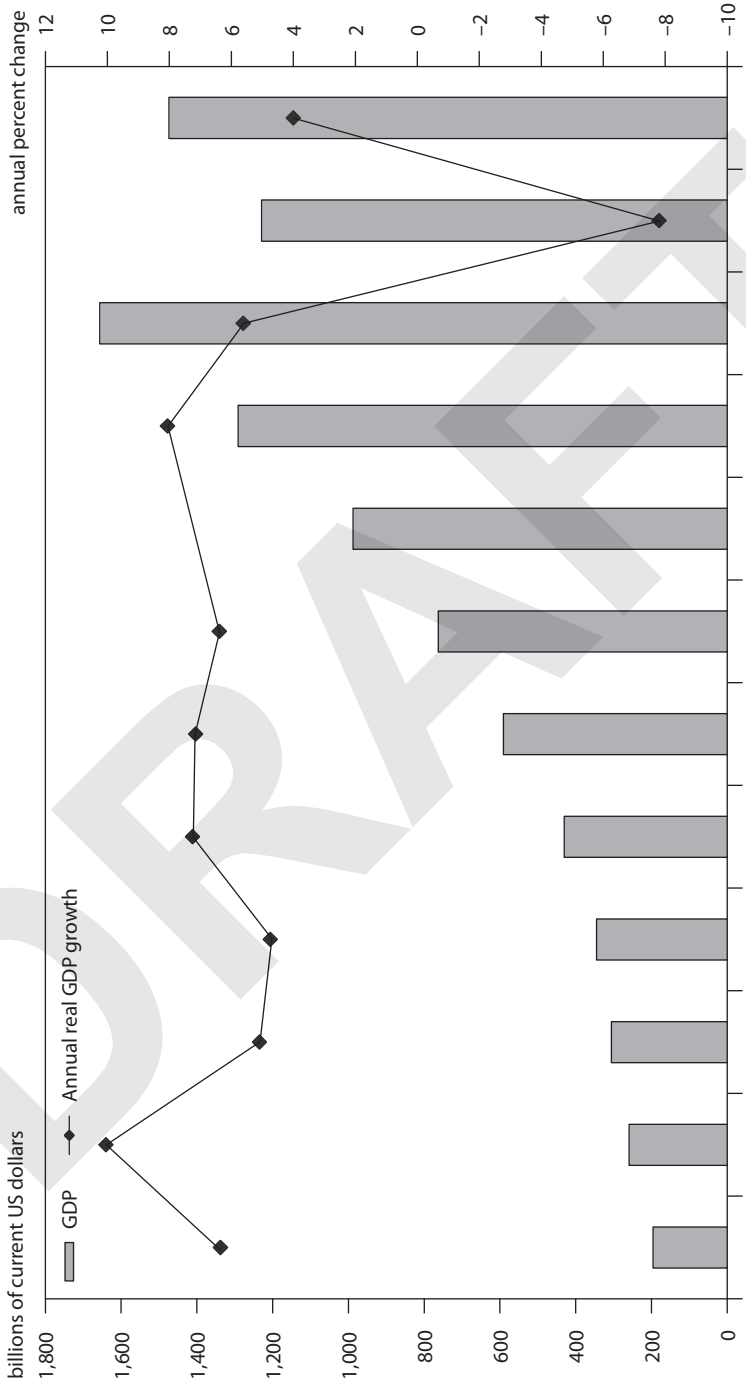


Figure 2.1 Russian GDP, 1999–2010

Source: IMF, *World Economic Outlook*, October 2010 (accessed on April 21, 2010).

in 2018, France in 2024, the United Kingdom in 2027, and Germany in 2028. By 2030, Russia would be the fifth largest economy in the world after the United States, China, Japan, and India. Factors underlying Russia's dynamism—in addition to abundant energy resources—are sound macroeconomic policies, an open economy, substantial investment, and high levels of education. Russia is weakest in terms of institutions, governance, and the rule of law.

Goldman Sachs made moderate assumptions about the conduct of economic policy and the development of institutions that support Russian growth, projecting that Russia's population, and thus its labor force, will contract sharply, as projected by the US Census Bureau. But the natural labor force contraction, caused by low nativity and high death rates, has so far been largely offset by immigration from former Soviet republics. The negative Goldman Sachs population forecast might be exaggerated, giving a downward bias to the GDP forecast.

Following the financial crash of August 1998, Russia's macroeconomic policies have been conservative. Russia recorded significant budget surpluses from 2000 to 2008, peaking at 7.5 percent of GDP in 2005 and 2006. Russia's exports surged to $472 billion in 2008 and its merchandise trade surplus to $180 billion.[4] The current account surplus reached $104 billion, or 6.3 percent of GDP in 2008, and its foreign currency reserves peaked at $598 billion in early August 2008. Meanwhile, Russia's public foreign debt plunged from 100 percent of GDP in 1999 to 2 percent at present. The only macroeconomic flaw was that inflation rose to 13.3 percent in 2008 (before the great recession) because of international and domestic overheating after an extraordinary boom. Huge foreign currency inflows, which were not successfully sterilized, were a major reason for rapid inflation (BOFIT 2010).

As late as the summer of 2008, the conventional wisdom was that Russia's economy would weather the global economic crisis and remain a safe haven, like China and India, but the crisis hit Russia unexpectedly hard in the fall of 2008. In 2009, its real GDP fell by 7.8 percent, more than that of any other G-20 economy, and its GDP in current US dollars plummeted by 26 percent to $1.23 trillion. Adverse shocks came from distress among financial firms, plunging exports, and falling commodity prices. Suddenly, Russia's corporate sector was cut off from global liquidity, while corporate and private foreign debt reached $500 billion. The government effectively bailed out the banks and large firms by engineering a gradual devaluation between November 2008 and January 2009, costing the country $200 billion of reserves. Russian exports fell by no less than 36 percent to $304 billion in 2009. Since imports contracted by almost as much, Russia maintained a large trade surplus of $112 billion.[5]

4. In 2008, Russian oil exports surged to $307 billion, aided by a spike in oil prices.

5. In 2008 Russia ranked in the top twenty largest importers in the world: $267 billion worth putting it in 17th place.

Russia suffered badly during the financial crisis for reasons that are still being analyzed. The country's high growth rate of the past decade appears a memory, and current policies without major structural reforms are likely to result in long-term growth of only 3 to 4 percent a year. The government no longer enjoys a budget surplus and is expecting a budget deficit of 3 to 5 percent of GDP until 2014. Inflation stays high at 8.8 percent in 2010. Russia has moved to a more flexible exchange rate policy aimed at keeping inflation low and avoiding excessive capital inflows. Its current account surplus is still substantial and is likely to continue to be so, but on the order of $50 billion or 3 percent of GDP annually, half the previous level. Russia's international reserves had risen to $484 billion on February 1, 2011, and are likely to stay sizable. For private firms, however, money has become scarce. An intense economic policy debate over possible reforms to promote modernization erupted in 2008, and the question today is the eventual shape of a reform package.

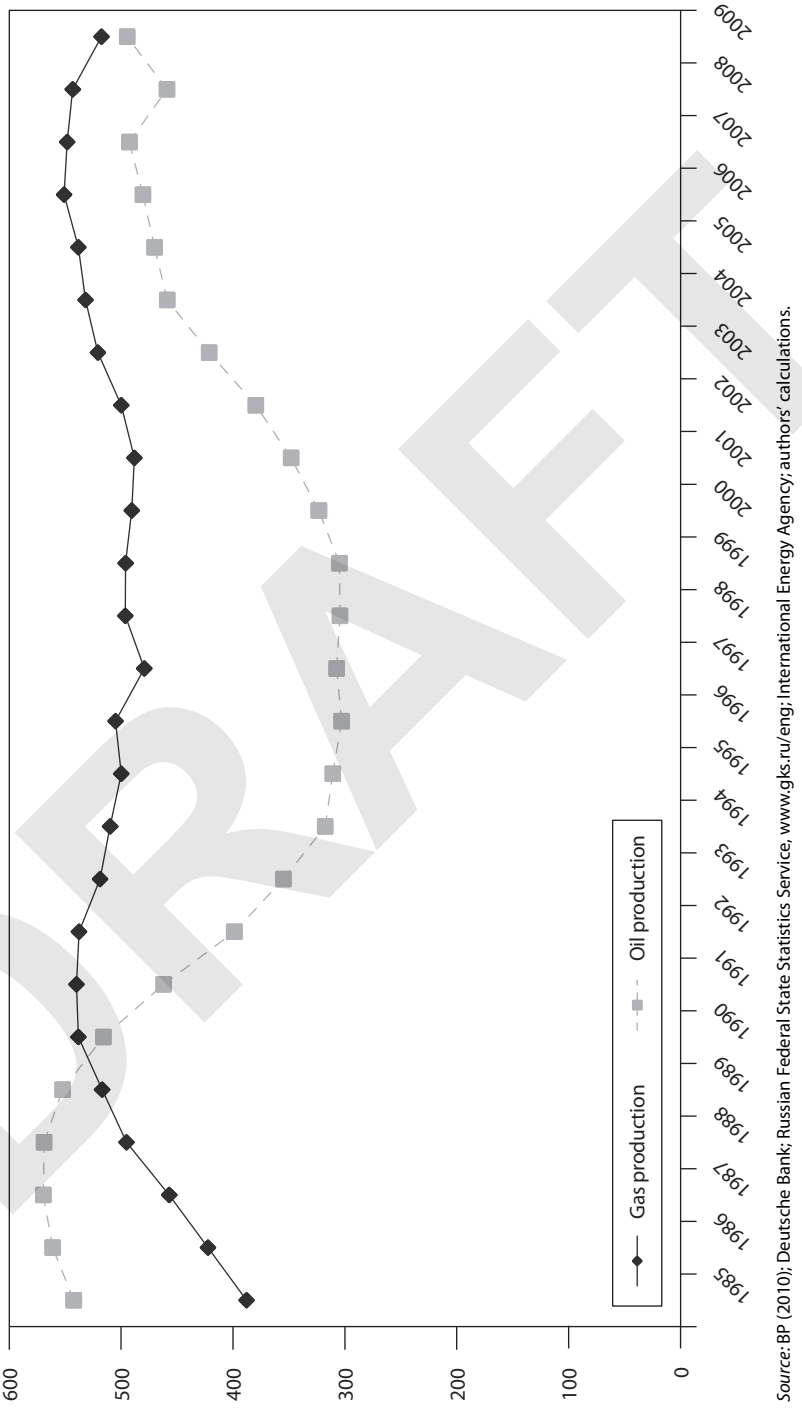
Russia has to choose between a low-growth strategy based on oil and a high-growth strategy based on development of its human capital. The high-growth strategy requires substantial reforms and further international integration. Until 2008, Russian leaders called their country an energy superpower, and for good reason. Energy dominates the economy, accounting for roughly one-fifth of GDP, two-thirds of exports, and half of state revenues. Russia is the biggest producer of primary energy in the world, with one-eighth of world crude output (exceeding even Saudi Arabia) and almost one-fifth of world natural gas output. For years, Russia was the world's largest gas producer; however, the United States surpassed it in 2009. Russia is also the world's biggest energy exporter, competing with Saudi Arabia for first place in oil exports and leading in natural gas exports. Russia holds about 24 percent of the world's known reserves of natural gas and 6 percent of known world oil reserves (BP 2010).[6] Because of limited exploration, Russia's reserves might be far larger than these figures.

However, the Russian energy sector is suffering from structural problems that spell stagnating volumes. From 1999 to 2004, Russia's oil production rose by no less than 50 percent, but since 2005 production has stagnated because of partial renationalization and high taxation, leading to limited exploration and development. Russia's output of natural gas has been almost constant since 1990, peaking in 2007. Output is now declining because of aging fields and failure to develop new giant fields or known secondary fields (figure 2.2). State-dominated Gazprom accounts for 75 percent of all gas production and controls both pipelines and exports. Large international investments in new oil and gas fields are needed to maintain and expand Russia's energy output.

Energy trade already is free of border barriers and is not directly affected by Russia's accession to the WTO. But the role of US companies in the exploitation of Russian energy resources, and Russian delivery of energy to the United

6. Proven reserves measure quantities that geological and engineering assessments indicate with reasonable certainty can be recovered from known reservoirs.

Figure 2.2 Russian oil and gas production, 1985–2009



Source: BP (2010); Deutsche Bank; Russian Federal State Statistics Service, www.gks.ru/eng; International Energy Agency; authors' calculations.

States, may be seriously affected by the US decision to grant, or not to grant, PNTR. A decision not to grant PNTR will be seen in Russia as a diplomatic slap, hardly a calling card for energy investment by US firms. However, the potential for energy collaboration between the United States and Russia is huge. Russia can play a major role in enhancing US energy security by providing additional and more diversified energy supplies.

In sum, Russia could become the world's fifth largest economy in 2030. The United States cannot ignore this booming market.

Russia: The Wealthiest of the BRICs

Among the leading emerging markets that belong to the trillion dollar club (Brazil, Russia, India, China, and Mexico), Russia has the highest GDP per capita both in dollar and purchasing power parity terms. Its GDP per capita in current US dollars in 2010 was more than two times higher than China's (see table 2.1). Goldman Sachs forecasts that Russia will be the only BRIC to approach the per capita income levels of developed European countries by 2050. Russia's middle class, which already accounts for 30 percent of the population, will therefore become an increasingly important market for US exports. Foreign brands are top choices for the Russian middle class.

Russia's higher income level is also reflected in superior social indicators. In most regards, Russia is slightly ahead of Brazil and Mexico but head and shoulders above China and India. Most impressively, in 2008, no less than 77 percent of college-age Russians received some college education, compared with 23 percent of Chinese and almost as high as the 83 percent figure for the United States (according to UNESCO). Moreover, 51 percent of young Russians actually completed a first college degree, compared with only 36 percent of Americans and 11 percent of Chinese.[7] The sophistication of Russian consumers makes the country all the more attractive to US exporters of merchandise and services.

The United States has so far not taken advantage of its opportunity to develop the US-Russian bilateral trade relationship, particularly with regard to US exports. Incredibly, Russia is only 31st among US export markets. America's total two-way trade with China in 2010 was almost 12 times larger than that with Russia and the comparative ratio reaches 22 times when energy trade is excluded (all 27 categories in the Harmonized Schedule [HS]). Meanwhile Europe's two-way merchandise trade with Russia, excluding energy trade, is about five times the US level. While US imports from Russia are rapidly catching up with US imports from India and Brazil,[8] US exports to Russia (in 2008) were still only one-half of US exports to India and less than one-third of US exports to Brazil.

7. Data are from UNESCO Institute for Statistics, Tertiary Education, available at http://stats.uis.unesco.org.

8. In 2010, US imports from Russia represented 84 percent of US imports from India and 104 percent of US imports from Brazil. In 2004, these figures had been 75 and 55 percent, respectively.

Table 2.1 Russia compared with other emerging-market countries, selected indicators, 2010

Indicator	Russia	Brazil	China	India	Mexico
GDP (market exchange rate, billions of dollars)	1,667	1,636	4,520	1,261	1,090
GDP per capita (market exchange rate, dollars)	11,739	8,626	3,404	1,066	10,216
GDP per capita (purchasing power parity, current international dollars)	16,034	10,526	6,189	2,868	14,546
Population (millions)	142	190	1,328	1,182	107
Two-way trade with the United States (billions of dollars)	28	54	335	45	386
FDI stock per capita (dollars)	1,512	1,499	288	104	2,736
Secondary education (percent)[a]	85	101	76	55[b]	0
Tertiary education (percent)[a]	77	34	23	14	27
Mobile phone subscription (per 1,000 people)[b]	1,322	785	478	304	708

a. This figure represents gross enrollment: a ratio of total enrollment, regardless of age, to the population of the age group that officially corresponds to the level of education shown. A gross enrollment ratio of 100 percent indicates that a country is, in principle, able to accommodate all of its school-age population, but it does not indicate the proportion already enrolled in the age group.
b. 2007 data.

Sources: IMF, *World Economic Outlook*, 2010; UN Comtrade Database, http://comtrade.un.org; UNCTAD Foreign Direct Investment Database, www.unctad.org; World Bank, *World Development Indicators*.

Russia's Role in World Trade

Merchandise exports have driven Russia's high economic growth. They increased sixfold from a low of $76 billion in 1999 to almost $400 billion in 2010 (figure 2.3). Soaring commodity prices, particularly for oil and gas, propelled the export boom, and export volumes have expanded fast. Even so, the share of exports in GDP has contracted, from 38 percent in 1999 to 20 percent in 2010, as the rest of the Russian economy caught up with the export sector.

While prospects for Russian trade are bright, Russia's share of world merchandise trade remains small, only 1.6 percent in 2000, rising to 2.9 percent in 2008; meanwhile, Russia's share of world services trade is even less (table 2.2). Of Russia's total exports of goods and services in 2010, mineral fuels accounted for 71 percent, followed by base metals, primarily steel, at 11 percent, and chemicals, at 6 percent. Machinery and equipment amounted to just 3 percent of total Russian exports (table 2.3).[9]

Following the 1998 crisis and ensuing devaluation, which seriously curtailed trade, Russia's merchandise imports rose sixfold from $34 billion in

9. "Nonspecified commodities" account for a significant share of Russian exports, roughly 18 percent.

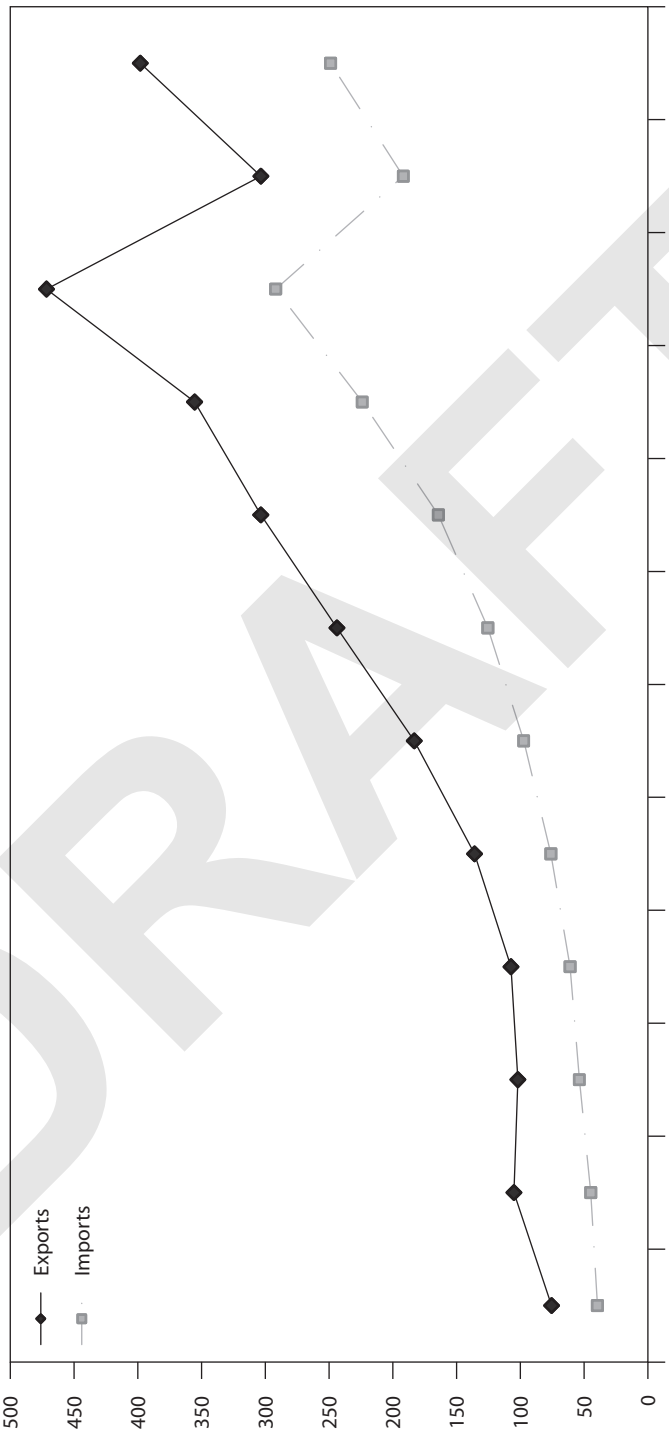


Figure 2.3 Russian merchandise exports and imports, 1999–2010

Source: Bank of Russia, June 2008 and April 2010.

Table 2.2 Russian and US merchandise and commercial services exports, 1995, 2008 (billions of current US dollars)

Country	1995	2008
Merchandise exports		
World	5,164	16,097
Russia	81	472
United States	585	1,287
Percent share in world merchandise trade[a] (percent)		
Russia	1.6	2.9
United States	11.3	8.0
Commercial services exports		
World	1,185	3,803
Russia	11	50
United States	199	292
Percent share in world services trade[a] (percent)		
Russia	0.9	1.3
United States	16.7	7.7

a. Exports of each country divided by world exports.
b. Includes significant reexports or imports for reexport.

Source: World Trade Organization Statistics Database, http://stat.wto.org.

1999 to $213 billion in 2010. In the long run, Russia's imports will catch up with its exports, as they persistently grew on average 20 percent a year until 2010. Russian Finance Minister Alexei Kudrin reckons that Russia does not really need international reserves larger than one year of imports, and the present reserves are almost twice as large, allowing the country to increase imports without fearing a foreign exchange shortage. The current Russian trade surplus therefore indicates the potential size of the additional Russian import market, which over time becomes much bigger: roughly the surplus plus the 20 percent per year export growth. According to the IMF's 2010 *World Economic Outlook*, Russia's current account surplus is expected to decline from a peak of $102 billion in 2008 to about $50 billion a year in the next couple of years and become a deficit of $13 billion by 2015.

Russia's imports are much more diversified than its exports, with the biggest groups being services, machinery, agricultural goods, and chemicals (see table 2.3 for more detail). An important feature of Russian imports is the high proportion of consumer goods. In 2008, Russia imported, in absolute terms, more goods for household consumption than China ($74 billion versus $44 billion). Russia's propensity to import consumer products, relative to industrial components and capital goods, is far higher than in the other BRICs. While in 2008, the share of consumer goods in total merchandise imports, excluding oil, reaches 25 percent for Russia, it is 14 percent in Brazil and only 4 percent for India and 3 percent in China (table 2.4). The figures demonstrate a vigorous demand for imported consumer products in Russia.

Table 2.3 Russian trade with the world, 2000, 2008 and 2010 (millions of US dollars)

	Russian exports			Russian imports		
Sector	**2000**	**2008**	**2010**	**2000**	**2008**	**2010**
Agriculture (HS 01-24)	1,299	8,390	8,071	6,978	33,348	33,756
Meat and offal (HS 02)	4	17	30	1,015	7,195	5,848
Fish and seafood (HS 03)	321	472	2,163	128	2,030	2,023
Fruits and vegetables (HS 07-08)	56	143	101	958	6,222	7,766
Cereals (HS 10)	96	3,255	2,404	551	468	231
Processed foods (HS 16-22)[a]	336	2,062	1,476	2,183	8,716	8,867
Tobacco products and substitutes (HS 24)	19	430	374	724	1,199	1,209
Mineral fuels, oils and distillates (HS 27)	52,844	307,372	261,850	1,487	4,080	3,407
Chemicals and plastics (HS 28-40)	5,627	25,492	22,847	5,524	34,178	35,886
Inorganic chemicals and compounds of metals (HS 28)	940	3,672	6,479	1,328	3,298	2,699
Organic chemicals (HS 29)	1,245	3,886	3,149	347	1,607	2,165
Pharmaceuticals (HS 30)	81	309	349	1,245	9,047	11,125
Fertilizers (HS 31)	1,581	11,832	7,389	4	40	41
Plastics (HS 39)	654	1,410	1,397	778	8,479	8,139
Wood, pulp, paper, and printed items (HS 44-49)	4,276	11,154	9,230	1,137	6,174	5,640
Precious stones and metals and jewelry (HS 71)	947	4,569	7,301	n.a.	670	479
Base metals (HS 72-83)	16,687	51,572	39,476	2,492	17,371	15,462
Iron and steel and articles thereof (HS 72-73)	6,856	31,692	20,918	1,726	12,580	10,708
Copper and articles thereof (HS 74)	1,262	4,117	4,919	81	584	581
Nickel and articles thereof (HS 75)	1,741	5,189	5,424	24	51	110
Aluminum and articles thereof (HS 76)	5,288	8,653	6,835	378	1,343	1,089

Machinery, electrical and precision equipment (HS 84-85, 90)	4,732	11,598	9,546	7,248	81,993	68,832
Boilers, machinery and mechanical appliances (HS 84)	2,877	7,151	5,656	4,281	45,942	37,036
Electrical machinery and equipment (HS 85)	1,189	3,271	2,732	1,917	28,079	25,792
Optical, photographic, precision and medical instruments (HS 90)	666	1,176	1,158	1,051	7,971	6,003
Transport equipment and parts (HS 86-89)	2,086	5,982	5,164	1,362	52,346	25,890
Motor vehicles (HS 87)	752	3,645	2,324	1,047	48,066	22,696
Aircraft (HS 88)	166	n.a.	n.a	16	1,831	n.a
Other products[b]	2,883	6,963	7,539	3,248	23,994	19,596
Commodities not specified according to kind (HS 99)	12,659	34,902	2,032	4,444	12,898	3,903
Services	9,565	29,240	n.a	16,230	45,598	n.a
Transportation	3,555	15,024	n.a	2,330	12,960	n.a
Travel	3,429	11,944	n.a	8,848	24,890	n.a
Financial services and insurance	135	1,819	n.a	448	3,153	n.a
Royalties and license fees	91	453	n.a	69	4,595	n.a
Total	113,605	491,252	367,892	50,151	312,650	212,851

a. Processed foods include prepared meat, fish and seafood, sugar, cocoa, cereal, vegetable and fruit preparations, and beverages.
b. Other products include HS categories 25-26, 41-43, 50-70, and 91-97.

Note: For services, this table uses statistics as reported by the Bank of Russia.

Sources: UN Comtrade Database, http://comtrade.un.org; USITC Interactive Tariff and Trade Dataweb, http://dataweb.usitc.gov; Bank of Russia; IMF Balance of Payments Statistics, www.imf.org.

Table 2.4 Imports of BRICs by end use, 1996, 2008 and 2010 (billions of US dollars)

	Brazil			China			India			Russia		
Sector	**1996**	**2008**	**2010**	**1996**	**2008**	**2010**	**1996**	**2008**	**2010**	**1996**	**2008**	**2010**
Goods for industrial use	39.2	129.6	125.3	121.7	1,234.0	n.a	23.6	195.3	n.a	24.8	198.2	129.8
Capital goods[a]	10.0	23.5	26.5	30.8	446.1	n.a	3.6	30.1	n.a	7.8	59.1	44.9
Parts of capital goods	6.4	20.4	22.6	18.3	265.7	n.a	2.6	15.8	n.a	2.0	12.5	14.2
Other transport equipment[b]	0.9	3.6	4.9	2.3	54.6	n.a	0.7	14.6	n.a	1.3	13.5	6.1
Parts of transport equipment[c]	3.6	22.9	13.8	3.1	54.6	n.a	0.8	21.3	n.a	1.2	56.8	13.7
Industrial supplies nes	16.7	55.5	55.5	64.6	386.7	n.a	15.8	110.2	n.a	11.7	54.9	49.4
Food, beverages for industry	1.6	3.6	1.9	2.6	26.3	n.a	0.1	3.3	n.a	0.7	1.3	1.5
Goods for household consumption	6.6	16.4	22.9	6.0	44.0	n.a	1.1	8.3	n.a	7.9	74.5	60.6
Passenger motor cars	1.6	5.3	8.5	0.4	14.1	n.a	nes	0.4	n.a	0.3	30.1	11.3
Consumption goods nes	4.0	9.8	12.7	5.0	27.3	n.a	0.5	5.0	n.a	6.0	36.8	39.8
Food and beverages	1.0	1.2	1.7	0.5	2.7	n.a	0.6	2.9	n.a	1.6	7.6	9.5
Fuels and lubricants	5.1	33.8	29.0	4.4	167.3	n.a	11.3	114.9	n.a	1.1	4.0	3.4
Processed	0.7	11.8	13.8	0.9	34.2	n.a	5.2	19.2	n.a	0.1	2.0	2.5
Primary	4.4	22.1	15.2	3.6	133.1	n.a	6.1	95.6	n.a	1.0	2.0	0.9
Goods nes	3.3	0.0	0.1	3.5	4.6	n.a	0.8	11.6	n.a	7.6	13.5	4.5
Total	54.1	179.8	177.3	135.6	1,449.8	n.a	36.8	330.0	n.a	41.4	290.2	198.3

nes = not elsewhere specified.
na = not available.

a. Except transportation equipment.
b. Excludes passenger motor cars.
c. Parts for transportation equipment are classified as goods for industrial use because aircraft parts are an important segment and because spare parts for household automobiles account for a small share of this trade.

Note: The values and categories are based on the BEC (Broad Economic Categories) classification. The category totals do not cover all products, since some products are only defined at high levels of dissagregation. Nevertheless, the values reported cover substantially all trade. For example, the values reported for Russia in 2006 represent about 98 percent of total Russian imports for that year.

Source: UN Comtrade Database, http://comtrade.un.org.

Russia's Role in US Trade

The United States plays a minor role in Russia's merchandise trade: It is the destination of only 3 percent of Russian exports and the source of just 4 percent of its imports in 2010.[10] In contrast, the European Union receives 49 percent of Russia's exports. The Commonwealth of Independent States (CIS) countries and East Asia attract 7 and 13 percent respectively (figure 2.4, IMF 2010). To some extent these figures reflect the undeniable facts of geographical proximity between the European Union and Russia and the boom of East Asia. Geographical proximity is a critical factor in natural gas trade.

Despite all these explanations, the US share of Russian trade is low, particularly when recent Russian import history and near-term prospects are considered. In 20, the United States accounted for as little as 4 percent of Russia's total imports, while Susan Collins and Dani Rodrik (1991, 134) calculated that, as early as 1989, the US share should have been 5.2 percent of Russia's imports.[11] In contrast CIS countries accounted for 9 percent of Russian imports, while East Asia and the EU accounted for 29 and 43 percent respectively (figure 2.5).

Table 2.5 presents a telling comparison of the 17 biggest economies in the world, besides the United States and its two neighbors Canada and Mexico. On average, US merchandise exports to these economies amounted to 2 percent of their GDP. But Russia is an extreme outlier: US exports in 2008—the last normal year before the great recession—amounted to only 0.6 percent of Russia's GDP. If US exports to Russia were to rise to the average for large economies, they would more than triple. From this simple observation, we conclude that the United States could easily double its exports to Russia under normal trading conditions.

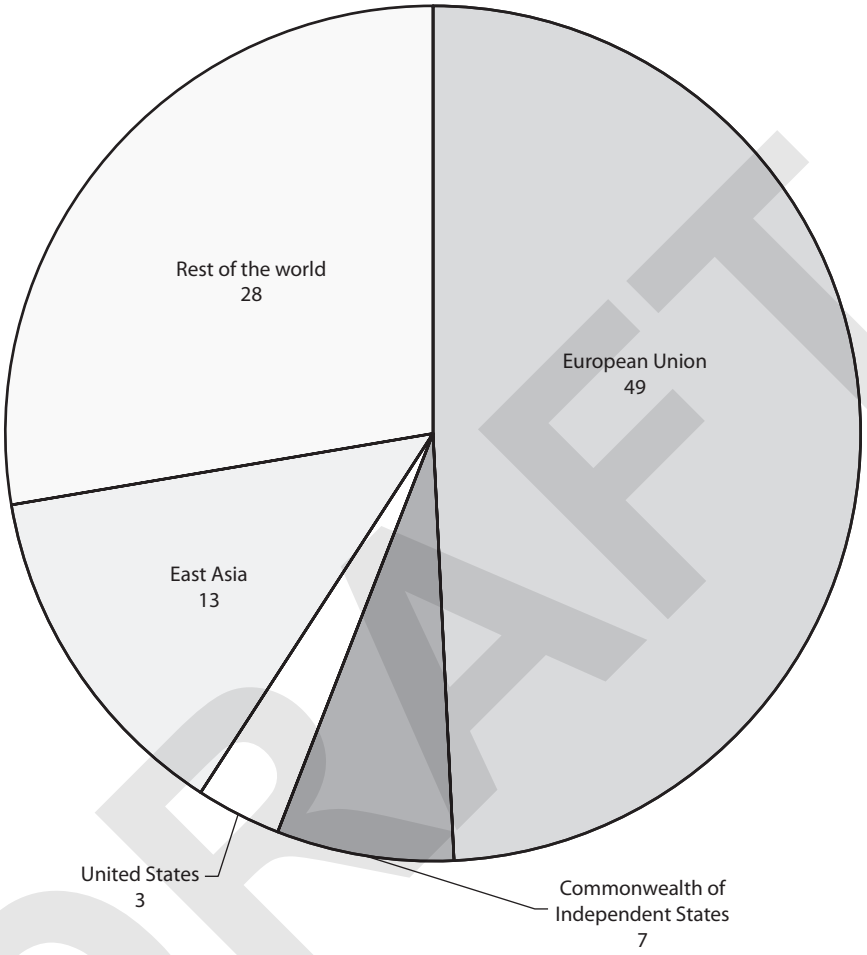
As these comparisons indicate, America's trade with Russia has so far been surprisingly limited. Russia's exports (goods and services) to the United States amounted to $28.4 billion in 2010, while US exports to Russia stood at just $8.6 billion. While US trade with Russia has been expanding rapidly, most of the growth consisted of US merchandise imports from Russia until 2005, but between 2005 and 2008 US merchandise exports almost doubled. Principal Russian exports to the United States are mineral fuels (essentially refined oil), $18.5 billion (65 percent of the total), iron and steel, $1.5 billion, and other metals (aluminum, nickel, and copper), $0.7 billion (table 2.6).

Industrial goods represent approximately 80 percent of US merchandise exports to Russia, but the US export structure has changed substantially and become more diverse in recent years, as US exports of motor vehicles, aircraft, and sundry equipment have taken off. US exports are concentrated in

10. We use data reported by US sources to the International Monetary Fund (IMF) for Russian exports to the United States; these estimates are substantially larger than figures from Russian sources.

11. Collins and Rodrik calculated for the Soviet Union. We estimate that 75 percent of the Soviet GDP originated in Russia.

Figure 2.4 Russia's major export partners, 2008 (percent)



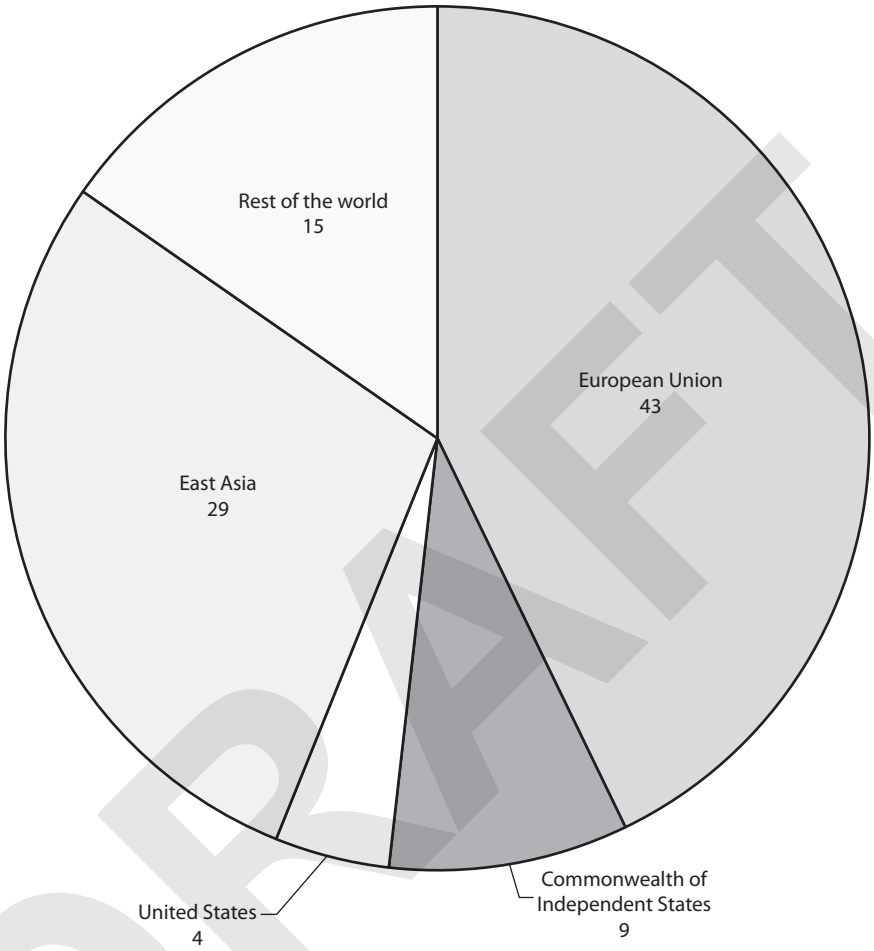
Source: IMF, *Direction of Trade Statistics* (accessed on July 8, 2010).

machinery and equipment ($3.1 billion), motor vehicles[12] ($2.1 billion), aircraft ($539 million), and poultry ($631 million).

A similar picture emerges for trade in commercial services. Again, with fast growth, total Russian two-way trade in commercial services (imports plus exports) almost quintupled between 1999 and 2008. In 2008, commercial services imports and exports amounted to 8 percent of Russian GDP (table 2.7).

12. These include passenger motor vehicles, as well as motor vehicles parts and nonmotor vehicles such as tractors, snowmobiles, buses, and tanks.

Figure 2.5 Russia's major import partners, 2008 (percent)



Source: IMF, *Direction of Trade Statistics* (accessed on July 8, 2010).

Accounting for about three-fifths of that figure, travel and transportation services dominate Russian cross-border trade in commercial services.

During the 2005 to 2008 period, US commercial services imports from Russia grew from $2.2 billion to $3.7 billion and US commercial services exports to Russia increased from $1.9 billion to $3.8 billion.[13] US-Russian services trade is thus balanced, but given US competitiveness in services, the low

13. Data on services trade use Russia as the reporter, and therefore these figures should be interpreted with caution.

Table 2.5 Export to GDP ratios, selected countries, 2008

Country	GDP, 2008 (current billions of dollars)	US merchandise exports to partner country, 2008 (billions of dollars)	Export/GDP ratio (percent)
Japan	4,887	66.6	1.4
China	4,520	71.5	1.6
United Kingdom	2,679	53.8	2.0
Italy	2,307	15.5	0.7
Russia	1,667	9.3	0.6
Brazil	1,636	32.9	2.0
Spain	1,601	12.3	0.8
India	1,261	18.7	1.5
Australia	1,058	22.4	2.1
Korea	931	34.8	3.7
Netherlands	877	40.2	4.6
Turkey	730	10.4	1.4
Poland	529	4.1	0.8
Indonesia	511	5.9	1.2
Belgium	507	29.0	5.7
Average			2.0

Sources: IMF, *World Economic Outlook*, October 2010; UN Comtrade Database, http://comtrade.un.org.

level of US commercial services exports to Russia is striking. Russia's demand for US educational services—typically a service highly demanded by other BRICs—has declined to very low levels compared with the late 1990s. By contrast, EU exports of commercial services to Russia were almost seven times as large as US exports in 2008, and some European nations are top providers of commercial services to Russia (table 2.8).

The dominant impression from these numbers is that trade between Russia and the United States is seriously underdeveloped and that US companies could find much larger export markets in Russia, especially since total Russian imports of goods and services are likely to double over the next five years. The recent fast expansion of two-way trade illustrates how great the potential is.

US Direct Investment in Russia

Despite Russia's weak legal climate,[14] its strong GDP growth, along with rising household incomes, has attracted considerable interest from foreign investors. Since 2002, foreign direct investment (FDI) inflows have grown dramatically,

14. The 2010 Commercial Guide for US companies highlights that corporate governance, transparency, and respect for property rights remain key concerns for foreign investors (US Department of Commerce. 2010, chapter 6). Similarly, the 2008 EU Commission stresses problems with corruption and the legal framework as the main concern of potential investors.

Table 2.6 Russian trade with the United States, 2000, 2008 and 2010 (millions of dollars)

	Russian exports			Russian imports		
Sector	**2000**	**2008**	**2010**	**2000**	**2008**	**2010**
Agriculture (HS 01-24)	335	465	436	860	1,858	1,189
Meat and offal (HS 02)	—	—	—	559	1,303	649
Fish and seafood (HS 03)	247	303	267	3	35	61
Cereals (HS 10)	—	3	1	109	12	7
Mineral fuels, oils and distillates (HS 27)	770	17,847	18,471	7	48	48
Chemicals and plastics (HS 28-40)	1,251	3,200	2,151	256	861	992
Inorganic chemicals and compounds of metals (HS 28)	1,039	1799	1279	136	110	143
Organic chemicals (HS 29)	58	79	88	22	35	55
Fertilizers (HS 31)	92	1,203	639	—	—	1
Wood, pulp, paper, and printed items (HS 44-49)	132	157	113	21	78	53
Precious stones and metals and jewelry (HS 71)	2,324	1588	710	1	31	11
Base metals (HS 72-83)	2,304	3,921	3,065	41	216	181
Iron and steel and articles thereof (HS 72-73)	517	1,830	1,497	24	104	78
Copper and articles thereof (HS 74)	115	202	—	—	3	1
Nickel and articles thereof (HS 75)	168	468	727	—	1	1
Aluminum and articles thereof (HS 76)	1,340	1,092	525	6	34	17
Machinery, electrical and precision equipment (HS 84-85, 90)	107	162	221	695	3,067	2,428
Boilers, machinery and mechanical appliances (HS 84)	49	55	112	484	2,089	1,651
Electrical machinery and equipment (HS 85)	32	53	64	126	544	395
Optical, photographic, precision and medical instruments (HS 90)	27	54	45	85	434	382

(table continues next page)

Table 2.6 Russian trade with the United States, 2000, 2008 and 2010 (millions of dollars) (*continued*)

	Russian exports			Russian imports		
Sector	**2000**	**2008**	**2010**	**2000**	**2008**	**2010**
Transport equipment and parts (HS 86-89)	43	96	102	251	2,713	795
Motor vehicles (HS 87)	3	10	3	45	2,092	484
Aircraft (HS 88)	37	76	95	202	539	276
Other products[b]	476	336	408	88	411	270
Services[c]	—	3,700	2,734	—	3,788	2,636
Total	7,761	31,472	28,411	2,220	13,071	8,603

— = not available

a. Processed foods include prepared meat, fish and seafood; sugar, cocoa, cereal, vegetable and fruit preparations; and beverages.
b. Other products include HS categories 25-26, 41-43, 50-70, and 91-98.
c. The data are from Russian sources and should be interpreted with prudence.

Note: This table shows data as reported by US sources, except for services, where data have been obtained from the Bank of Russia.

Sources: UN Comtrade Database, http://comtrade.un.org; UN Service Trade Database, http://unstats.un.org/unsd/servicetrade; USITC Interactive Tariff and Trade Dataweb, http://dataweb.usitc.gov.

Table 2.7 Services trade for selected emerging-market economies, 2008 (percent of GDP unless otherwise noted)

	Brazil	China	India	Mexico	Russia
Total two-way trade	28	64	53	59	52
Merchandise trade	23	57	40	55	44
Services trade	5	7	13	4	8
Exports of goods and services	12	27	20	28	28
Exports of goods	12	32	14	27	28
Exports of services	2	3	8	2	3
Imports of goods and services	14	29	29	30	21
Imports of goods	11	25	25	28	16
Imports of services	3	4	4	2	5
Composition of services exports (percent of commercial services exports)					
Transportation services	18	26	11	13	29
Travel services	19	28	11	71	23
Composition of services imports (percent of commercial services imports)					
Transportation services	22	32	24	14	17
Travel services	23	23	17	34	32

Sources: UN Comtrade Database, 2008, http://comtrade.un.org; UN Service Trade Database, 2008, http://unstats.un.org/unsd/servicetrade.

Table 2.8 Russian trade in services, selected destinations, 2008 (millions of dollars)

	Russian exports		Russian imports	
Country	**Value**	**Share**	**Value**	**Share**
Total	51,131	1.00	75,468	1.00
Commonwealth of Independent States	10,634	0.21	6,287	0.08
European Union	20,650	0.40	26,669	0.35
United Kingdom	4,300	0.08	4,457	0.06
Germany	3,581	0.07	4,400	0.06
Cyprus	3,118	0.06	2,745	0.04
Finland	1,052	0.02	1,951	0.03
France	1,158	0.02	1,618	0.02
APEC countries	7,057	0.14	6,832	0.09
China	870	0.02	992	0.01
United States	3,700	0.07	3,688	0.05
Other countries	9,495	0.19	16,736	0.22
Egypt	25	0	2,034	0.03
Turkey	2,197	0.04	4,287	0.06
Switzerland	1,681	0.03	1,856	0.02

APEC = Asia-Pacific Economic Cooperation forum

Source: Bank of Russia, Macroeconomic Statistics, 2008, www.cbr.ru/eng/statistics.

reaching $75 billion in 2008. Still both the total dollar stock of FDI and FDI expressed as a share of GDP are quite low in Russia. As of end-2008, Russia had accumulated an inward FDI stock of $214 billion, some 13 percent of GDP, according to UNCTAD, largely concentrated in energy, wholesale trade, and metallurgy. While Russia's FDI to GDP ratio is low compared with those of world leaders, its FDI stock per capita is four times higher than in China (table 2.1).[15]

While the United States was a leading source of FDI destined for Russia during the 1990s, US investment has not caught up with the FDI boom in the 2000s. Consequently, the US share of Russia's FDI inflows and stocks has dropped. According to the US Bureau of Economic Analysis, US FDI flows into Russia were only $2.7 billion in 2008 (less than 4 percent of Russia's total inflows that year) and the total US FDI stock was just $20.6 billion (less than 10 percent of Russia's total accumulated FDI stock; table 2.9). US FDI stock in Russia is low compared with those in the other BRICs. It is also low from a Russian point of view, as it represents only about one-sixth of the EU stock of FDI in Russia (Eurostat 2010). As might be expected, US FDI is heavily concentrated in oil exploitation (69 percent), but there is increasing interest in other sectors such as manufacturing (primarily food processing and chemicals) and wholesale trade.

However, official statistics on US FDI may underestimate true levels. Many US companies invest in Russia through a subsidiary, and FDI is then recorded as originating in the country where the subsidiary is located. For instance, the McDonalds subsidiary in Canada has undertaken all of that company's investment in Russia. Moreover, it is not possible to obtain detailed industry information from US official sources because, for confidentiality reasons, the US Bureau of Economic Analysis suppresses industry-level data in its published reports when the figures might reveal the position of individual firms.

Nevertheless, the low US investment figures probably signal the aversion of US firms both to the business climate in Russia and to investment by a US-incorporated company. In 1992, the United States and Russia signed a bilateral investment treaty (BIT), which was ratified by the US Senate the ensuing year. But the BIT has never been ratified by the Russian State Duma and is therefore not in force, even though Russia has ratified BITs with 50 other countries. As a consequence, many US corporations prefer to invest from a subsidiary in a country with better investment protection in Russia. In the US-Russian Sochi declaration of April 6, 2008, both the US and Russian presidents committed themselves to negotiating a new BIT "to provide a stable and predictable framework for investment." However, no significant, practical steps have yet been taken to negotiate a new treaty, as WTO accession has been given priority. Another reason for delay is that the US government undertook a lengthy review in 2004, of the clauses in its BIT agreement and, as a consequence, the new US model BIT makes stronger demands on partner countries.

15. UNCTADstat Database, available at http://unctadstat.unctad.org.

Table 2.9 US foreign direct investment stock in Russia, 2000 and 2008
(millions of dollars)

Sector	2000	2008
Total	1,147	20,628
Mining	79	13,093
Manufacturing[a]	419	4,815
Food	247	(D)
Chemicals	77	61
Fabricated metals	0	(D)
Machinery	25	−6
Computers and electronic products	6	52
Electrical equipment and appliances	13	5
Transportation equipment	1	2
Professional services	29	125
Wholesale trade	19	502
Information	319	64
Depository institutions	138	1,217
Other finance and insurance	−56	−26
Other industries	201	829

(D) = data in the cell have been suppressed to avoid disclosure of data of individual companies.

a. The value for total manufacturing may be less than the sum of the listed subsectors because the subsectors listed are only a partial subset of the subsectors of manufacturing and because the direct investment position in an individual country/sector can be negative.

Source: US Bureau of Economic Analysis, www.bea.gov.

In 2009 the US began another review of its BIT model, which will have further implications for the US-Russian agreement.

Whatever the causes, the low investment numbers appear to reflect missed opportunities by US companies, both for investment and commerce. When US multinationals establish a presence in foreign markets, they import specialized inputs, production technology, and management expertise, often from the United States (Graham and Wada 2001). More US FDI to Russia would expand US exports of goods and services.

Russia has long maintained informal government oversight with respect to major foreign investments, especially when they have a national security dimension. In May 2008, Russia finally adopted a Law on Foreign Investment in Strategic Industries, which identified 42 sectors of the economy as strategic. They include military sectors and nuclear industries but also oil, gas, fisheries, aircraft, telecommunications, and media. This law requires any foreign investor seeking to buy a stake of over 50 percent in a company in any of these sectors to receive government approval. The threshold is stricter for state-controlled foreign companies: these foreign investors must seek permission to acquire more than 25 percent of the shares in a strategic enterprise. The law has been criticized in Russia as excessively restrictive, but businessmen

welcomed the enhanced legal clarity. The Russian government is considering liberalizing the strategic industries law. Moreover, in 2010, the US Trade Representative obtained commitments from Russia to limit the scope of trade-related investment measures (TRIMs).

Russia's accession to the WTO will boost FDI by reinforcing Russia's commitments to international legal standards and mutual market opening. In 2010, Thomas Rutherford and David Tarr (2010) concluded that gains to Russia from eliminating barriers to the establishment of foreign service firms could reach 3.7 percent of GDP. In fact they estimate that 95 percent of total gains from WTO accession come from liberalizing barriers to FDI in the business services sector. Our own econometric analysis (reported in Appendix A) indicates that the total inward FDI stock in Russia could increase by 50 percent, much of it in the services industries.

The potential for growth of US FDI to Russia is probably far larger than these estimates imply. Simple arithmetic shows that the US FDI stock in Russia (currently at 10 percent of world FDI in Russia) needs a 40 percent increase to reflect the share of total US outward FDI stock in total world FDI stock (about 14 percent in 2008).[16] Of course, Russian inward FDI will continue to grow strongly—as suggested by both the 2008 figures and our econometric estimates. If the US firms approach their potential share, the annual dollar growth could be spectacular.

16. This figure excludes US FDI in Canada and Mexico.

3

US Opportunities through Russia's Accession to the WTO and PNTR

The Russian economy became quite open after the end of communism. Fundamental market economic reforms were carried out in the early 1990s, with the liberalization of foreign trade and prices in 1992. Most of the economy was privatized between 1992 and 1996, so that the private sector produced some 70 percent of the total Russian output. Since 1999, macroeconomic stabilization has held and, apart from a bout of inflation before the Great Recession, Russia's macroeconomic statistics are stellar, with persistent budget surpluses from 2000 to 2008, permanent current account surpluses, and the third largest international currency reserves. In the beginning of the 2000s, large parts of a Tax Code and a Civil Code were adopted. As Russia's market had already opened up, the task of the WTO accession process has been to bring Russia's legislation into conformity with WTO standards. By and large, this legislative work was accomplished by 2003, with a new Customs Code that entered into force in January 2004 being the main milestone (USTR 2006). Subsequently, Russia updated its Customs Code again to comply with rules of the new Customs Union. Moreover, Russia will be obliged to commence negotiations to join the WTO Government Procurement Agreement no later than four years after its accession to the WTO.

On November 19, 2006, Russia concluded its bilateral accession agreement with the United States. The main elements of this agreement are described in box 3.1.[1] In most cases, a staged reduction of three to six years applies to the provisions ensuring enhanced market access. As Russia's WTO accession dragged out, however, it was not until the fall of 2010 that Russia fulfilled many of the nontariff commitments outlined in the 2006 bilateral agreement. Russia has passed long-overdue IPR legislation, but not much else in connection with the 2006 agreements. The United States continues to pursue issues

1. More detailed information is to be found on the USTR website at www.ustr.gov.

Box 3.1 Russia's bilateral WTO accession agreement with the United States

On November 10, 2006, the Office of the US Trade Representative and the Ministry of Economic Development and Trade of the Russian Federation announced that they had reached a bilateral agreement in principle on the terms of Russia's accession to the World Trade Organization (WTO). Its major elements are:

- *Tariff cuts.* Russia will be cutting its tariffs on a broad range of industrial and agricultural goods. Key US industrial exports (aircraft and parts, chemicals, high-technology products, and medical, construction, and agricultural equipment) will enjoy tariffs averaging 6.5 percent. This is not only beneficial for US exporters but is also a boon to Russian industry and consumers as cheaper inputs become available for manufacturing and consumers enjoy lower-priced goods. Average rates of bound tariffs by sector are summarized in table B3.1.1.
- *Steel scrap.* Russia has committed to reducing export duties on steel scrap, an important input for US steel mini-mills, to one-third of their current levels over a five-year period.
- *Agriculture: Tariff rate quotas and the bilateral meat agreement.* Russia agreed to honor its commitment to its bilateral meat agreement with the United States, which set out specific shares of quotas on poultry, beef, and pork through 2009. The bilateral agreement also provided a framework for negotiating future market access in the post-2009 period.
- *Agriculture: Sanitary and phytosanitary standards (SPS).* Russia agreed to open its market to frozen US pork. Under various side-agreements that accompanied the main agreement, Russia authorized US agencies to certify US slaughter, processing, and cold chain facilities that intend to export pork and poultry products to Russia. Russia also agreed to conditions for the resumption of US beef exports to Russia, provided that the United States remains a "controlled BSE risk" country, as designated by the World Organization of Animal Health (OIE).[1] Certification of US beef exporting plants will be conducted jointly by the responsible agencies of both countries. Russia will adopt international standards concerning SPS regulations in line with those in the WTO agreement, an issue that is of great interest to US meat exporters affected by high-profile non-science-based SPS barriers raised by Russia in 2010.
- *Civil aircraft and parts.* Sales of civil aircraft will see phased-in tariff reductions from the current 20 percent to single-digit tariff levels, and tariffs will also be reduced on leased aircraft. Tariffs on civil aircraft parts will drop to an average of 5 percent. In addition, the Side Agreement on Leasing clarifies the tariff treatment for aircraft entered temporarily into Russia pursuant

to an operational lease. These have also benefited from lower tariffs (ranging from 8 to 10 percent), starting in November 2006 and remaining in force until January 1, 2011.

- *High-technology products.* Russia agreed to become a signatory to the WTO's Information Technology Agreement (ITA), the plurilateral agreement under which WTO members commit to reducing tariffs to zero on imports of high-technology products. This commitment is particularly meaningful in combination with Russia's commitments that mass market products with encrypted technology can be easily imported into Russia. Multilateral talks continue to ensure a transparent and nondiscriminatory system in Russia for the importation of encrypted products.
- *Intellectual property rights.* The agreement includes a "binding blueprint" for the protection and enforcement of intellectual property rights, including specific commitments by dates certain to take the following steps: enact laws to protect pharmaceutical data; fight copyright and internet piracy; ensure closing of illegal plants, enact criminal penalties for intellectual property crimes; and ensure that the Russian legislative regime, including Part IV of the Civil Code, is fully compliant with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Necessary TRIPS-compliant legislation is now in place in Russia, and negotiators continue to pursue effective implementation of these measures bilaterally and in the context of the multilateral WTO working party discussions.
- *Financial services.* Russia has agreed to 100 percent foreign ownership of banks, securities firms, and insurance subsidiaries upon accession. Operation through branches will be allowed for foreign insurance companies after a transition period, but not for foreign banks. Russia retains the right to impose a 50 percent equity cap on the banking and insurance sectors (foreign capital in the Russian banking system is currently about 13 percent), meaning that new licenses and additions to charter capital could be restricted once the threshold is reached. However, exclusions may soften the impact of this provision.
- *Other services.* The agreement includes improved market access for numerous US services firms, from express delivery to engineering to environmental and business services.

Source: US-Russia Business Council.

1. US beef was shut out of the Russian market in the mid-2000s, but as of 2010Q3 Russia is the eighth largest export market in the world for US beef, with US beef exports to Russia now approaching highs seen back in 2000.

Table B3.1.1 Russian commitments under WTO accession: Applied and bound tariff rates (percent)

Category	Applied tariff rate[a]	Initial bound rate	Final bound rate
Alimentary goods and agricultural raw materials[b]	14.8	34.9	25.2
Mineral production, including fuels and energy sources	5.4	11.1	5.4
Chemical industry production, caoutchouc	8.5	10.2	6.1
Wood and cellulose and paper goods	8.7	14.6	7.8
Textiles, apparel and shoes	11.7	18.3	12.4
Precious stones, precious metals, and goods therof	20.0	25.0	20.0
Metals and metal goods	11.3	19.3	11.7
Machinery, equipment, and means of transportation	9.5	14.8	8.7
Gypsum, glass, and ceramics	15.5	20.2	14.4
Raw materials for the tanning industry, furs, and goods thereof	14.9	21.1	13.2
Other (clocks, musical instruments, and other items)	18.0	20.2	16.4

a. As of January 2001.
b. Except textile fibers of natural origin.

Note: Trade-weighted averages based on imports of 2000.

Source: WTO Tariff Download Facility, 2006, http://tariffdata.wto.org.

with respect to implementation of the encryption and SPS/plant inspection agreements, and the enforcement of the IPR agreement.

Again, it should be emphasized that all of Russia's concessions will become effective for US firms and farmers only if Congress grants PNTR to Russia. The gains for the US economy will come from increased exports, better investment access, and a more normal US-Russia commercial relationship. Box ES.1 in the Executive Summary summarizes the main qualitative and quantitative gains.

Tariff Cuts and Tariff Rate Quotas[2]

Russian import tariffs are above OECD levels, but they are not high by comparison with other emerging-market economies. In 2008, the applied average tariff was 10.8 percent, reflecting a weighted average of 10.2 percent for industrial goods and 14.2 percent for agricultural goods.[3] Once Russia smoothed its tariff profile in 2000, the average tariff level has barely been an issue in negotiations. However, Russia still maintains exceptionally high peak tariffs of 20 per-

2. Tariff rate quotas (TRQs) are two-tiered tariff rates that vary according to the quantity imported of a given product. After imports surpass a predetermined threshold volume, tariffs automatically increase, effectively discouraging further imports of that product.

3. WTO Statistics Database, http://stat.wto.org (accessed July 30, 2010).

cent or more on selected products: automobiles, aircraft and aircraft parts, motorcycles, sugar, distilled spirits, wine, fruit, processed food, forest products, CDs, and DVDs. However, it reduced import tariffs for many agricultural goods in 2007 in order to curb inflation. Table 3.1 shows Russian tariffs on significant imports from the United States.[4] Under the terms of Russia's WTO accession, tariffs on these goods will decrease.

Press releases from the Office of the US Trade Representative (USTR) point to significant concessions in agriculture and manufactures, as Russia has agreed to bind applied tariffs at lower average levels than its 2000 average applied tariffs. According to Alexei Portanskiy, director of Russia's WTO Information Office, "the average *weighted* tariff for industrial goods will go down from 10.2% to 6.9%" from two to seven years after accession to the WTO (USDA 2007a).

A more subtle but equally relevant impact of Russian accession to the WTO lies in the fact that Russia will have to commit to tariff "bindings," meaning guaranteed upper limits on its tariffs for detailed tariff lines. These bindings will curtail the scope for Russian bureaucrats to accommodate protectionist interests by selectively raising tariffs and will greatly increase the certainty of market access for US firms. Russia's commitments as to the extent of coverage of tariff bindings and top tariff rates are more liberal than commitments found in many current WTO members, notably South Asian nations.

The Russian bound tariff levels will also decline during a short phase-out period. For example, within six to eight years of accession, Russia's average *weighted* bound tariffs will drop from 35 to 25 percent in agriculture and foods, from 10 to 6 percent in chemicals, from 19 to 12 percent in metallurgic products, and from 15 to 9 percent for machinery and transportation equipment (WTO Information Center 2006).[5] After the staged reduction, the average weighted bound tariff for chemicals and machinery and transportation equipment will actually be lower than the average weighted applied tariff for these items as of January 2001. This is a worthy accomplishment.

Access for US Agricultural Exports

In addition to limiting tariffs and quotas, the terms of Russian accession to the WTO provided an opportunity to address problems involving sanitary (animal health) and phytosanitary (plant) regulations (SPS). Russian import restrictions on US meat (poultry, pork, and beef) were a prominent issue given the size of the Russian market and the importance of meat in current US-Russian trade. Looking to the future, Russia's concessions under its

4. On top of the import tariff, most imported goods are subject to a value-added tax of 18 percent and some goods to a excise tax. The Russian value added tax rate is in line with the European norms.

5. A more extensive listing of sectors is available at www.wto.ru. This is a website in both Russian and English run by the Russian Ministry of Economic Development.

Table 3.1 Russian tariffs on major US exports, 2010

HS 6-digits	Product description	Import value (milllions of dollars)	Share from United States	Representative MFN tariff range[a]
0207.14	Chicken cuts and edible offal, frozen	315	0.05	25 or 60
8431.43	Parts for boring or sinking machinery, nesoi	211	0.03	0
8703.23	Passenger motor vehicles (1,500 cm^3 < cc < 3,000 cm^3)	73	0.01	20 or 25
8473.30	Parts for automatic data processing machines, nesoi	37	—	0
8703.24	Passenger motor vehicles (cc over 3,000 cm^3)	90	—	25
8414.80	Air pumps and other gas compressors, nesoi;	104	0.02	5
8431.49	Parts for bulldozers and other grading machinery, nesoi	50	0.01	0
2401.20	Tobacco, partly or wholly stemmed/stripped	30	—	5
8802.40	Aircraft nesoi, (unladen weight < 15,000 kg)	—	—	20
8701.90	Tractors, nesoi	25	—	5 or 15
8802.30	Aircraft nesoi, (2,000 kg < unladen weight < 15,000 kg)	—	—	20
8433.51	Combine harvester-threshers	3	—	5
8431.39	Parts for lifting, handling, or loading machinery, nesoi	16	—	0
3912.11	Cellulose acetates, nonplasticized, in primary forms	54	0.01	5 or 10
2844.10	Natural uranium and its compounds and products	56	—	5
8705.90	Special purpose vehicles, nesoi	13	—	5 to 15
0203.29	Meat of swine, nesoi, frozen	95	0.01	15 or 60
8701.20	Road tractors for semi-trailers	4	—	5 or 15
5907.00	Textile fabrics, impregnated, coated or covered	9	—	5
0802.12	Almonds, fresh or dried, shelled	55	0.01	5
8429.52	Mechanical shovels and excavators, self-propelled	21	—	5

0303.78	Whiting and hake, frozen	12	—	10
8413.70	Centrifugal pumps, nesoi	26	—	0
8467.81	Chain saws, nonelectric motor, hand-directed	60	0.01	15
8502.39	Generating sets, electric, nesoi	23	—	0
8708.99	Parts and accessories for motor vehicles, nesoi	12	—	5
8432.30	Seeders, planters and transplanters	4	—	5
5502.00	Artificial filament tow	67	0.01	5 or 10
8704.10	Dumpers (dump trucks) designed for off-highway use	83	0.01	5
8430.41	Boring or sinking machinery, nesoi, self-propelled	43	—	0
8525.20	Transmission and reception apparatus	—	—	5 or 10
8474.10	Machines for sorting or washing earth and minerals	12	—	0
0203.22	Meat of swine, hams and cuts thereof with bone, frozen	51	0.01	15 or 60
2101.11	Coffee extracts, concentrates and preparations	—	—	10
8803.30	Parts of airplanes or helicopters, nesoi	—	—	5
	Subtotal	1,654	0.26	14[b]
	Total	6,409	1.00	12[c]

MFN = most favored nation; nesoi = not elsewhere specified or included

a. Russian tariffs on agricultural products and motor vehicles are often in the form of compound tariffs. For the sake of simplicity, the reported "representative tariffs" exclude items and components listed in the form of specific tariffs. We also exclude preferences on meat products.
b. Trade weighted tariff for listed items. In instances where several tariffs are listed, highest ad valorem estimate was chosen.
c. Weighted MFN average tariff for total Russian trade with the world, as reported by the 2006 Russian Economic Survey.

Sources: USITC Interactive Tariff and Trade Dataweb, http://dataweb.usitc.gov; official website of government of the Russian Federation, http://npa-gov.garweb.ru.

accession documents should provide a solid opportunity not only for larger US meat exports to Russia but also for greater diversity of US agricultural exports. To realize these gains, American farmers and food processors need the same access as leading competitors for the Russian food market, namely Brazil, China, and the European Union, and passage of PNTR is an essential step toward that goal.

Over the past decade, US meat producers have faced growing competition from foreign suppliers in world markets, especially Brazil. The US Department of Agriculture expects that the challenge will grow stronger over the next decade, particularly in beef and poultry and to a lesser degree in pork (USDA 2007b). The Russian market is a large prize in the global contest. In terms of quantity, Russia is the world's second largest import market for beef, pork, and poultry. According to the US Department of Agriculture (USDA 2009), Russia will retain its top position.[6]

In 2010, US exports of meat to Russia amounted to $649 million, mainly chicken ($316 million)[7], but under less restrictive conditions exports could be much larger—at least double that amount. On top of strong competition from Brazil and the European Union in the Russian meat market, Russian resistance to import liberalization became more acute after 2000, when domestic chicken and pork production took off.[8]

Russia's accession to the WTO will improve access for US producers. Tariff and quota commitments bring greater certainty of market access for US meat producers, who will benefit from lower tariff bindings.[9]

Given past experience, US meat producers will reap significant benefits from revised Russian SPS regulations. With the signing of a protocol in conjunction with the bilateral accession agreement in November 2006, the two

6. The US Department of Agriculture (USDA 2009) estimates that Russia's agricultural imports should continue to grow, although at a lower rate than in past years. Imports of poultry and pork may decrease as domestic production increases and due to a more restrictive TRQ regime imposed on these imports in December 2008. Russia would nonetheless remain the world's second largest agricultural importer among emerging-market economies.

7. Exports to Russia in 2010 have not yet recovered to their prerecession highs. In 2008 exports of meat were $1.3 billion, consisting mainly of chicken ($822 million).

8. In January 2009, Russia imposed more restrictive TRQ regimes for poultry and pork. The tariff quota volume for poultry was cut from 1.252 million to 0.952 million metric tons, and the out-of-quota tariff rate was raised from 40 to 95 percent for poultry and from 40 to 74 percent for pork. The rate for beef, however, was lowered to 30 percent.

9. Additionally, under the terms of the Meat Agreement signed in 2005, Russia will bind its tariffs on imports of field crops at duty free or 5 percent tariff levels. In general, low tariff bindings are a powerful commitment as they curtail the room of maneuver of the Russian Ministry of Agriculture to accommodate pressures of domestic producers on various agricultural products from field crops to livestock to processed foods. However, the Russian market is not a major export market for the top US field crop and is not projected to become one in the future (USDA 2007b). US field crop producers will benefit indirectly from Russia's WTO accession if it results in higher exports of US meats to Russia.

countries agreed upon a framework for reopening the Russian market to US exports of beef and frozen pork for retail. Previous bans on US exports of poultry, due to avian influenza, were eliminated through a separate agreement in February 2006. In principle, the bilateral protocol of November 2006 resolved problems with certification of pork and beef packing plants that export to Russia. Russia authorized the US Department of Agriculture's Food Safety and Inspection Service to certify new facilities and committed to responses within specific time frames. Russia agreed to reopen its market to US beef and accepted freezing of pork as sufficient protection against trichinae, thereby allowing imports of US pork. In practice, however, SPS barriers still hamper US exports. Russia's accession to the WTO will mean that Russia accepts the SPS disciplines set forth in the Marrakesh Agreement Establishing the WTO and the fact that these disciplines curtail the "policy space" for arbitrary decisions in the future.[10] This will reduce some of the irritants that now obstruct US exports.

Rising incomes are changing the profile of the Russian consumer: Higher incomes have "sensitized them to the quality of food they buy, thus increasing demand for both greater variety and enhanced quality" (AAFC 2010). Russia's WTO accession commitments will allow US agriculture and food processors better access in "nontraditional" products that enjoy strong demand in Russia. For example, the terms of accession involve significant cuts in tariffs on grapes, apples, and processed foods typically exported by the United States (e.g., tree nuts, food ingredients, snack and frozen foods, California wines, and whiskeys and bourbons).

One source of growth for specialty products lies in the expansion of the Russian retail food market. "Consumerism" has propelled the transformation of retailing, with increased penetration of foreign food chains. By 2020 Russia is expected to surpass France as the largest grocery market in Europe (AAFC 2010). Consumer spending on food grew by 70 percent between 2002 and 2007 (AAFC 2010, and analysts estimate the annual growth rate to remain strong (AAFC 2010).

US consumer-oriented foods could do far better in tapping the Russian market. Current US shares of Russian imports of consumer-oriented foods, aside from meat, are remarkably low. For example, in 2010 Russia imported from all countries $673 million worth of grapes, $1,049 million worth of apples and pears, $825 million of wine, and $1,320 million worth of cheese. However, US exports to Russia of all these products together barely added to

10. The WTO agreement holds countries accountable to internationally recognized SPS measures with regard to agricultural trade and provides foreign producers legal mechanisms to contest arbitrary rulings. In 2006, for example, the Russian Federal Veterinary and Phytosanitary Surveillance Service (VPSS) banned imports of rice—the only grain product imported in significant quantities by Russia (mainly from East and South Asia). According to the US government (USDA 2007a), the ulterior motivation for the measure was that "VPSS appears to be using rice to demonstrate its ability to control trade in grain products." This sort of practice would be more difficult after WTO accession.

$28 million.[11] While PNTR will not solve all the obstacles that plague American exports—Russia's lack of familiarity with American food brands plus strong competition from EU and Chinese producers—the failure of PNTR will surely mean that US producers are effectively shut out of Russian retail markets.

To sum up, while Russian imports of agricultural products have sharply recovered since 1999, US agricultural exports to Russia have not caught the wave, to a large extent because of political interference but also because US producers are simply absent from large swaths of the Russian market. As a result, US agricultural exports to Russia have increased slowly from 2000 levels, from around $1 billion in 2001 to $1.2 billion annually in 2010. A key area where PNTR could prove beneficial for US farmers is by ensuring most favored nation (MFN) access for a vast number of agricultural products and foods, for which the Russian market is already large and buoyant. With better access, US agricultural exports could double in a few years and then continue to grow strongly for years to come, drawn by the vigorous growth of Russian agricultural import demand, which averaged about 30 percent annually between 2005 and 2008, and rebounded after the recession, growing 19 percent between 2009 and 2010.

Access for US Industrial Exports

While gains for US agriculture loom large, they pale in comparison to the potential of PNTR to boost US manufactured exports. Industrial goods already account for 86 percent of US exports to Russia, and their fast growth has accounted for nearly all the growth in US exports to Russia since 2003. However, vast potentials lie ahead. For one thing, Russia's rapid GDP growth will continue to boost imports of manufactured goods for both household use and industrial plants. Secondly, over the coming decade, Russia will want to expand its manufactures trade beyond base metals and a few other products. Russia's intra-industry trade, currently one of the weakest in Europe, should grow rapidly as Russia develops additional pockets of world class manufacturing, with a supplementary boost from inward foreign direct investment (FDI).

Driving the point closer to home, US exports to Russia are today more in line with US exports to countries like Pakistan or Indonesia rather than to the other BRICs (Brazil, India, and China), a shortfall that springs from comparatively modest Russian imports of manufactured goods.[12] Despite the rapid growth overall of Russian imports, in 2010 US industrial exports to Russia in-

11. While this figure pales against the vastly larger value of established US meat exports to the Russian market, the potential is substantial. Specialty products account for an increasing share of US agricultural exports worldwide. In 2010, total US exports of all the products listed in the text (including nuts, spirits, and prepared food) were 1.5 times larger than total US meat exports to the world ($19 billion versus $12 billion).

12. While US agricultural exports to Russia surpass those to Brazil and India, US industrial exports to Russia represent about 30 percent of US industrial exports to Brazil and 50 percent of US industrial exports to India. US-Russia trade is even less significant in comparison to China.

creased fourfold from their pre-1998 level (i.e., prior to the Russian crisis). It is noteworthy that China's accession to the WTO led to a surge in two-way US-China trade in manufactures: US industrial imports from China increased nearly fourfold between 2001 and 2009, while US industrial exports to China increased threefold between 2001 and 2009. Russia could follow the same pattern on the US exports side, but without the import boom that followed China's accession. The reasons for optimism about US export prospects are that Russia already holds larger international currency reserves than the government aspires to, Russia's current account surplus is therefore set to decline, and a reduction of Russian trade barriers will open many markets to US manufactures, both capital goods and consumer goods. The reason to be skeptical of booming US imports from Russia is that Russian firms don't have abundant skilled cheap labor as do their Chinese counterparts and produces few competitive manufactures.

By the standards of other BRICs, as well as other emerging-market countries, US FDI in the Russian manufacturing sector is very modest (table 3.2). The estimates in appendix A assume a 50 percent increase in Russia's *total* inward FDI stock following accession to the WTO. However, since the US FDI stock in manufacturing is presently so modest, it might well increase by three or four times. If so, that could provide an additional boost to US manufactured exports of around 5 percent. For one thing, the US FDI stock in Russian manufacturing is very low in areas of greatest interest to US firms, namely transportation equipment, chemicals, and machinery. For all of these sectors taken together, the current US stock of FDI is a trivial fraction of US stock of FDI in the corresponding sectors of other major emerging-market countries listed in table 3.2. Thus if the US stock of FDI in manufacturing were to increase fourfold, it would roughly equal the *average* FDI stock in Mexico, Brazil, and China.

Accession Opportunities for US Exports

Anecdotal evidence suggests that many leading US manufactured exports could do much better in the Russian market. While US aircraft exports (HS 8802) to Russia accounted for roughly 30 percent of Russian imports of aircraft, they were worth just over $530 million per year (based on figures from the US International Trade Commission).[13] By contrast, in 2008 US aircraft exports to other BRICs were in billion dollar figures. PNTR not only will cut border barriers substantially, making foreign aircraft more competitive in the Russian market, but will also provide a strong incentive for modernizing Russian transportation services.

The central US demand in bilateral negotiations was to reduce the Russian tariff on aircraft and aircraft parts. In the bilateral US-Russia protocol, Russia

13. USITC Interactive Tariff and Trade Dataweb, available at http://dataweb.usitc.gov.

Table 3.2 US stock of foreign direct investment in the manufacturing sector, selected countries, 2000 and 2008 (millions of dollars)

	Total manufacturing		Transportation equipment		Chemicals	
Country	**2000**	**2008**	**2000**	**2008**	**2000**	**2008**
Mexico	19,599	2,182	5,960	5,030	4,124	4,306
Brazil	17,688	20,357	3,416	2,783	3,741	4,607
China	7,076	21,428	652	2,146	1,122	4,614
India	1,098	3,149	57	80	256	1,579
Russia	419	2,768	1	−95	77	60
Total	45,880	49,884	10,086	9,944	9,320	15,166

	Food		Machinery	
Country	**2000**	**2008**	**2000**	**2008**
Mexico	1,427	2,482	1,228	(D)
Brazil	1,686	1,277	2,618	2,157
China	286	730	218	1,534
India	61	8	310	658
Russia	247	1,665	25	43
Total	3,707	6,162	4,399	4,392

(D) = data in the cell have been suppressed to avoid disclosure of data of individual companies. The cell's value is not reflected in the totals.

Note: Stock is measured on a historical cost basis.

Source: US Bureau of Economic Analysis, www.bea.gov.

agreed to reduce tariffs on several key US industrial exports (aircraft; chemicals; assorted high-technology items; and medical, construction, and agricultural equipment) to an average of 6.5 percent. In general, Russia agreed to cut tariffs on manufactured goods to a simple average tariff of 8 percent, which could result in a trade weighted average tariff of 6.5 percent for manufactured imports.

More specifically, sales of civil aircraft will see phased-in tariff reductions from the current 20 percent level to single-digit tariffs, and tariffs will also be reduced on leased aircraft. Tariffs on civil aircraft parts will drop to an average of 5 percent. Russian tariffs on imports of US automotive imports will fall from their current level of 20 to 35 percent to 15 percent (Coalition for US-Russia Trade 2010a), which would create significant market access gains for US suppliers.[14]

14. It is worth mentioning that very little can be concluded from statistics on the sectoral impact of *average* tariff cuts at high levels of aggregation. Since tariff schedules contain a very large number of tariff lines (often more than 8,000 at the 8-digit level) averages can "hide" significant peaks. A clear picture will emerge when detailed schedules are released showing Russian commitments at the 8-digit level.

Another category where the Russian market offers vast opportunities, so far largely untapped by US producers, is pharmaceuticals. In 2008, Russia was by far the largest importer of pharmaceutical products among the BRICs ($9 billion).[15] US exports of pharmaceuticals to Russia, however, stood at only $70 million, less than US pharmaceutical exports to India ($87 million), despite the fact that total Indian pharmaceutical imports represent only one-tenth of Russian imports. Likewise, total US exports of pharmaceuticals to China ($329 million) and Brazil ($712 million) were six and ten times the size of US exports to Russia in 2008, although total pharmaceutical imports by these countries are about half as large as Russian imports of pharmaceuticals. PNTR will almost certainly foster the performance of US exports in the Russian pharmaceutical sector.

The bilateral US-Russia protocol expressly required action by Russian authorities to address an important concern of US pharmaceutical companies, namely the protection of confidential pharmaceutical test data in connection with a drug's registration in Russia. The Duma also passed legislation in September 2010 extending IPR protection to pharmaceutical test data and approved a six-year period of protection for pharmaceutical proprietary data. This was a key element of the 2006 bilateral protocol. This may lead to larger investment and exports by US pharmaceutical firms to the Russian market.

Nontariff Barriers

Russia no longer imposes many formal nontariff barriers; and, since 2005, the government has streamlined many existing import license requirements. However, to protect national health and security, Russia still maintains import licenses for explosive substances, drugs, nuclear substances, medicines, white spirits, hazardous wastes, fish and roe, and products containing encryption technology. A serious, perennial problem has been Russia's ambition to formalize previously informal controls on imports and exports of products containing encrypted technology. The United States has firmly opposed this initiative. The 2006 bilateral agreement set out an understanding on procedures for importing technology products with encryption, and this agreement might provide the basis for a new understanding on trade in encrypted products and technology. In 2010 and 2011 US and Russian negotiators have continued to make progress in their effort to resolving outstanding issues related to encryption. USTR continues to engage Russian negotiators and officials from Russia's Federal Security Service, which holds jurisdiction over rules for import of goods containing encryption. In addition, Russia will commence negotiations to join the WTO Government Procurement Agreement no later than 4 years following accession.

15. We use 2008 data for comparison to the BRICs since 2010 data are not available for China and India.

High Technology

Russia has agreed to become a signatory to the WTO's Information Technology Agreement (ITA), the plurilateral agreement under which WTO members commit to reducing tariffs to zero on imports of high-technology products. This commitment is particularly important because of the progress that has been achieved toward ensuring that certain products with encrypted technology can be imported into Russia. The two countries are continuing to work together to ensure a transparent and nondiscriminatory system for the importation of such goods into Russia.

Metals

The terms of Russia's accession call for reduced export tariffs on key metals. Russia will reduce export duties on steel scrap, an important input for US steel mini-mills, to one-third of their current levels over a five-year staged reduction period. Russia will also eliminate its export duty on copper cathode. In addition, Russia has eliminated export quotas on platinum and palladium used in goods ranging from jewelry to vehicle exhausts.[16]

US Tariffs and Trade Remedies

On average, US protective measures against Russian imports are minor. US applied tariffs on imports from Russia amount to an average of only 0.4 percent, which is the US tariff for mineral fuels, the dominant US import from Russia (table 3.3).

At present, only four US antidumping actions are in force against Russian products (table 3.4). Three of them concern ferrous metals (ferrovanadium and nitride vanadium, magnesium metal, and silicon metal) and one is imposed on nitrogen fertilizer (urea). Current US trade remedy actions are limited because of booming world demand for commodities. However, when the business cycle turns, new antidumping and countervailing duty actions could be brought against Russian ferrous metals and chemicals. During the great recession of 2008–09 the United States initiated expedited reviews of antidumping orders on magnesium, silicon metal, urea ammonium, and cut-to-length steel plate; three of these are still in force. PNTR does not in any way change or weaken US trade remedy laws, including antidumping statutes and regulations.

Strengthening the Rule of Law

In 2002 and 2003, Russia enacted a new legal framework for the protection of intellectual property rights, including amendments to its laws on trademarks,

16. Robyn Paxton, "Platinum exports secured as Russia repeals quotas," *Moscow Times*, January 16, 2007.

Table 3.3 US tariffs on major Russian exports, 2010

HS 8-digit number	Product description	Import value (millions of dollars)	Share from Russia	Duties (percent unless otherwise specified)	
				Collected	Non-NTR rate
7601.10.60	Aluminum (o/than alloy), unwrought nesoi	254	0.01	—	11.0
2844.20.00	Enriched Uranium, plutonium, and their compounds	1,049	0.04	—	—
7408.11.60	Refined copper, wire, 6 mm < cross section < 9.5 mm	—	—	—	28.0
7601.20.90	Aluminum alloys nesoi, unwrought nesoi	202	—	—	10.5
7110.21.00	Palladium, unwrought or in powder form	241	0.01	—	—
7207.12.00	Iron/nonalloy steel semifinished products nesoi	494	0.02	—	20.0
7502.10.00	Nickel (o/than alloy), unwrought	687	0.03	—	6.6 ¢/Kg
0306.14.40	Crabs, dried, salted or in brine, frozen	219	0.01	—	—
7201.10.00	Nonalloy pig iron	450	0.02	—	$1.11/t
4412.14.05	Plywood sheets n/o 6 mm thick	—	—	—	50.0
7606.12.30	Aluminum alloy, plates/sheets/strip	36	—	2.8	13.5
2901.21.00	Ethylene	245	—	—	—
7102.39.00	Nonindustrial diamonds, worked, but not mounted	99	0.00	—	10.0
2814.10.00	Anhydrous ammonia	105	0.00	—	—
7110.11.00	Platinum, unwrought or in powder form	25	—	—	—
3102.80.00	Mixtures of urea and ammonium nitrate	157	0.01	—	—
7209.16.00	Iron/nonalloy steel, in coils, 1mm < thick < 3mm	3	—	—	0.4¢/kg + 20
3104.20.00	Potassium chloride	378	0.01	—	—
8905.20.00	Drilling or production platforms	—	—	—	—
7208.39.00	Iron/nonalloy steel, width 600mm+	6	—	—	0.4¢/kg + 20
2901.22.00	Propene (Propylene)	168	—	—	—

(table continues next page)

Table 3.3 US tariffs on major Russian exports, 2010 (*continued*)

HS 8-digit number	Product description	Import value (millions of dollars)	Share from Russia	Duties (percent unless otherwise specified)	
				Collected	Non-NTR rate
7110.31.00	Rhodium, unwrought or in powder form	91	—	—	—
7110.29.00	Palladium, in semimanufactured forms	58	—	—	—
8105.20.60	Cobalt (other than alloys), unwrought	56	—	—	—
2843.90.00	Compounds of precious metals	—	—	—	25.0
2208.60.50	Vodka, in containers each holding over 4 liters	—	—	—	$1.32/ liter
7302.10.10	Rails for railway or tramway tracks	5	—	—	1.0
2902.20.00	Benzene	50	—	—	—
7202.49.50	Ferrochromium, with 3 percent or less of carbon	105	—	2.9	30.0
9701.10.00	Paintings, drawings and pastels	18	—	—	—
7208.37.00	Iron/nonalloy steel, in coils, 4.75mm < thick < 10mm	31	—	—	20.0
8108.90.60	Titanium, wrought nesoi	213	0.01	15.0	45.0
7202.91.00	Ferrotitanium and ferrosilicon titanium	3	—	3.7	25.0
8108.20.00	Titanium, unwrought; titanium powders	7	—	14.3	25.0
7225.11.00	Alloy silicon electrical steel, width 600mm+	1	—	—	28.0
7208.38.00	Iron/nonalloy steel, in coils, 3mm < thick < 4.75mm	23	—	—	20.0
	Subtotal		5,479	0.21	0.7
	Other nonoil exports	2,620	0.10	0.8	
	Mineral fuels (HS 27)	17,930	0.69	—	
	Total	26,029	1.00	0.2	

NTR = normal trading relations; nesoi = not elsewhere specified or included

Source: USITC Interactive Tariff and Trade Dataweb, http://dataweb.usitc.gov.

Table 3.4 US trade remedy actions against Russian imports

Product affected	Type of measure	Effective date	Current status
Ferrovanadium and nitride vanadium	AD duty order	October 1995	In force
Magnesium metal	AD duty order	April 2005	In force
Silicon metal	AD duty order	March 2003	In force
Solid urea	AD duty order	July 1987	In force
Ammonium nitrate	AD duty order	May 2000	Suspended
Certain cut-to-length carbon steel plate	AD duty order	October 1997	Suspended
Hot-rolled carbon steel flat products	AD duty order	July 1999	Suspended
Uranium	AD duty order	October 1992	Suspended
Certain steel products[a]	Safeguard	March 2002	Terminated[b]
Certain steel wire rod and welded line pipe[c]	Safeguard	March 2000	Terminated

AD = antidumping

a. Products included certain carbon and alloy flat-rolled steel, tin mill products, hot-rolled bar and light shapes, cold-finished bar, rebar, certain welded pipes and tubes, fittings and flanges, stainless steel bar, stainless steel rod, and stainless steel wire.
b. Upon termination of the safeguard measure in December 2003, the president mandated the Steel Monitoring and Analysis System to continue to enforce licensing requirements on imports of certain steel products.
c. Russia was not a major US supplier for these products, but the measures may have affected a few Russian exporters.

Source: USITC (2010).

appellation of origin, patents, and protection of computer software and databases. In 2004, Russia amended its Law on Copyright and Related Rights. It also reinforced penalties for violations of intellectual property rights (IPR) by amending the Criminal Code and in 2010 enacted additional legislation to bring its laws into compliance with WTO rules. Even so, US rights holders and businesses have been increasingly concerned about the deteriorating IPR enforcement situation in Russia. US copyright industries estimate that they lose more than $1.7 billion annually due to copyright piracy in Russia (films, videos, sound recordings, books, and computer software)US industry estimates that over 80 percent of all DVDs and about 66 percent of music recordings on the Russian market are pirated (Baucus and Grassley 2005). The counterfeiting of patented and trademarked goods, especially consumer goods, such as wine, distilled spirits, and pharmaceutical products, is another serious problem for US companies.

US demands on Russia in the course of WTO accession negotiations have focused on the implementation of existing Russian IPR legislation and enforcement issues. In particular, the United States had asked Russia to clamp down on the many known plants producing pirated optical discs, but US concerns have recently centered on internet piracy in Russia. The United States has also been concerned about the leniency of Russian courts in IPR cases. All in all, the United States demanded that Russia prove a commitment to enforcement of its own IPR legislation. The bilateral protocol contains a "binding blueprint" for actions against piracy and counterfeiting. It aims to improve the protection and enforcement of intellectual property rights before Russia completes its accession to the WTO. Enforcement actions are specified in great detail. IPR issues were also addressed in the multilateral WTO negotiations so that Russia will fully implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) upon accession. In response to these demands, as noted above, the Russian Duma has passed some changes to Russia's Civil Code, and several measures have been taken to improve IPR enforcement.

Accession will also bring about commitments related to the transparency of policymaking, including publication of proposed regulations and provisions for public comment.

Access for US Service Providers

The greatest effects from WTO accession on the Russian economy are expected in the services sector, which is currently protected by strict formal and informal barriers. Greater liberalization in the services sector will advance the modernization of Russia's infrastructure. According to recent estimates, about 85 percent of total Russian gains from WTO accession would result from liberalizing the barriers to FDI in the services sectors. These gains could amount to 3.7 percent of Russian GDP (Rutherford and Tarr 2010).

Russia's market access commitments in the services sector are ambitious, and in fact they typically go beyond commitments made by the Chinese gov-

ernment in the context of China's WTO accession.[17] In addition to market access commitments, WTO accession will push Russia to improve the transparency of its regulatory system—in other words, to disclose the standards applied and the review processes necessary to meet the standards. The absence of transparency fosters uncertainty and corruption and constrains FDI in the Russian services sector.

Improved market access and transparency are not merely concessions to foreigners. Countries with underdeveloped services sectors, like Russia, often benefit from liberalization through a boost in services sector productivity. Ultimately, the productivity gains reach consumers through lower prices on a quality-adjusted basis.[18] In addition, these gains sometimes raise the productivity of downstream manufacturing firms that use a range of services such as finance and transportation (Rivera-Batiz and Rivera-Batiz 1992; Arnold, Javorcik, and Mattoo 2007).[19]

The United States is a highly competitive services producer, and Russia's WTO accession will result in new opportunities for US firms. With $526 billion of exports in 2008, the United States is the world's leading exporter of cross-border services and enjoys a large and growing trade surplus in this category—roughly $160 billion (Bureau of Economic Analysis [BEA] statistics).[20] However, most US services "exports" take the form of foreign sales by US-owned affiliates in the services sector, which were already about 50 percent higher than cross-border exports in 2007. This is also the case in US-Russia services trade, where cross-border US exports stood at $3 billion in 2007, while sales of US affiliates in the Russian services sector may have doubled that figure.[21]

17. This is the case in most areas, but Russia has been less keen to liberalize key aspects of banking (i.e., branching) or services in strategic sectors such as energy services. The comparison with China is all the more interesting, as the 2006 Trade Policy Review on China states that China's commitments in its General Agreement on Trade in Services (GATS) schedule "are relatively extensive by developing country standards" (WTO 2006, 163).

18. For many years, South Korea had pursued a development strategy that placed high priority on manufacturing activities at the expense of the services sector, which was, as a result, largely underdeveloped. Kim and Kim (2000) analyze productivity growth in the Korean services sector in 1970–97 and find that liberalization had a positive influence on the productivity of the liberalized sectors.

19. Mattoo, Rathindran, and Subramanian (2005) have suggested that, when services liberalization comes hand-in-hand with regulatory improvements, it may lead to "dynamic gains" measured in faster GDP growth. Francois (1995) and Baldwin and Forslid (2000) argue that financial services liberalization is the key channel through which countries can obtain the dynamic gains. However, the link between trade liberalization and dynamic GDP gains is still debated (see, e.g., Nordas, Miroudot, and Kowalski 2006).

20. Unlike the picture in merchandise trade, the United States maintains a large trade surplus with China in services. According to BEA data, in 2008, US cross-border services exports to China amounted to $16 billion while cross-border services imports amounted to $9.8 billion.

21. To avoid disclosure of data for individual companies, The BEA does not publish sales of various industries in Russia. However, the BEA reports that sales of US-owned affiliates in the Russian wholesale trade sector alone stood at about $3.5 billion in 2005.

The Coalition of Services Industries (CSI) has identified opportunities for US firms in Russian transportation, telecommunication, computer and related services, finance, insurance, express delivery, energy, and professional services—in other words, all those sectors where US presence is currently low.[22] The USTR reports that Russian WTO accession will entail considerable liberalization in all those sectors. Hence, given the predictions of Rutherford and Tarr (2010) and the successful performance of US services sectors in the previous instances of WTO accessions by large trading nations, especially China, it is sensible to expect vast opportunities ahead.

Logistics and Other Commercial Services

To be sure, many services traded between the United States and China "involve intermediary functions that facilitate product, payment, and information flows between producers and consumers" (USITC 2006, 67). These "logistics services" are intimately related to trends in merchandise trade—for example, just transportation and port services together account for about one-fifth of US services exports to China and nearly one-third of US services imports from China in 2008.[23] However, US cross-border services exports to China have grown in other key sectors too, such as education, tourism, and financial services, although China retained some restrictions on financial services. The services that experienced the fastest growth post WTO accession were business, professional, and technical services, which grew on average 14 percent annually between 2003 and 2008.

Russia's accession to the WTO will create new opportunities for US exporters of commercial services such as transportation and travel, leading to a more robust relationship characterized by stronger investment links. Increased merchandise trade and FDI will boost cross-border trade in commercial services, but so will the elimination of barriers to logistic services (transportation, supply chain consulting, and transportation management). Based on a survey study, the USITC (2005) concludes that the speed and cost of processing cargo through Russian airports and seaports and the quality, efficiency, and costs of customs procedures all suffer compared with leading emerging markets, and they have hardly improved.[24] Improvements in logistic services in turn could boost merchandise trade. For example, the USITC (2005) suggests that improved airport, seaport, and customs logistics are

22. See the CSI website at http://www.uscsi.org/publications/papers/Bush_Putin.htm.

23. Elsewhere we argue that, after its accession to the WTO, Russia is unlikely to follow the path of China and become an exporting powerhouse for manufactures. Accordingly, US logistics services trade with Russia will probably not enjoy the same growth as with China.

24. But Russia gets high marks on regulatory aspects that directly affect the productivity of the logistics service providers and stands out as a country where foreign firms are likely to receive similar treatment as domestic firms in logistics services.

generally associated with higher US merchandise exports to a country. Among the 25 leading emerging markets considered in that study, Russia stands out as the one where US (and Russian) exports could obtain the largest benefits from reforms.

Important barriers to trade in services exist in Russia, indicated by large price differentials in several services sectors.[25] The prices charged for transportation, financial, and telecommunication services in Russia would fall sharply in the wake of Russia's accession to the WTO. To cite one example, the prices for air transportation and maritime services are currently twice as high as they would be if Russian barriers were slashed to the same level as Singapore, the country with the fewest restrictions (Kimura, Ando, and Fujii 2004b). The weighted average price of financial services is about 40 percent higher than it would be without restrictions, with the insurance sector being the most insulated (Kimura, Ando, and Fujii 2004a). Users of telecommunication services would enjoy a reduction in the quality-adjusted cost of purchasing telecommunication services by some 20 percent (Jensen, Rutherford, and Tarr 2004c). These beneficial effects will arise from the entry of more competitive foreign companies in the Russian services sector, provided that Russia can ensure a sound regulatory framework.

Financial Services

Russia insisted on ceilings on the share of foreign ownership allowed, the possibility of operating branches of foreign companies, and the right to provide certain services, while the United States urged Russia to accept both unlimited foreign ownership and the operation of branches of foreign financial companies. The legal hurdles to establishing a new subsidiary are greater than for a branch, and the subsidiary must maintain its own capital and reserves, leading to higher costs of operation. Foreign majority-owned insurance companies have been subject to a 49 percent equity cap for firms writing life insurance and casualty insurance required by statute (e.g., automotive and other forms of liability insurance). In addition, the total capital of all foreign companies in the Russian insurance sector is limited to 25 percent. The European Union agreed with Russia to have its companies exempted from the 49 percent cap on these subsectors, and the United States naturally demanded equal treatment.

In the end, Russia accepted greater liberalization in insurance and almost complied with the US requests for banking. Upon accession, Russia will allow 100 percent foreign ownership of banks, securities firms, and nonlife insurance firms, and for life insurance companies 100 percent ownership within five years (51 percent upon accession). Russia retains its discretion to limit

25. A thorough comparative assessment of Russian barriers in the services sector was conducted by the USITC (2005), which focuses specifically on logistics services, broadly defined to include all means of transportation and related retail, finance, telecom, and information activities.

new foreign direct investment in banking and insurance, should foreign investment grow to exceed 50 percent of total investment in each of these two sectors (it is currently 16 percent in insurance and 26 percent in banking). Moreover, the existing investments are carved out and not counted, which means that the 50 percent is not an actual ceiling. Direct branching will be allowed for foreign insurance companies nine years after accession, but no similar concession is contemplated for foreign banks.

Telecommunications

This sector has been very liberal in the Russian economy, but the new Law on Communications, which came into effect in January 2004, introduced a novel 49 percent cap on foreign equity ownership. In the bilateral negotiations, the United States successfully got Russia to agree to abolish this cap.[26] Russia will open its telecommunication services market to all foreign suppliers and allow foreign telecommunication companies to operate as 100 percent foreign-owned enterprises. However, under the 2008 Law on Foreign Investment in Strategic Industries, explicit government approval is required for foreign firms to enter the telecom sector. Russia has also committed to bringing its regulations concerning the operations of telecom firms into conformity with the WTO Basic Telecommunications Reference Paper. This will place US telecom providers in a better position to participate in modernizing the Russian telecommunication system, which, according to government plans, could involve total investments of $33 billion.

As this survey makes evident, the Russian market can offer a great many opportunities for US exporters that will open up, but only if Russia joins the WTO and if the United States grants it PNTR. The breadth of the opening of the Russian market is illustrated by the bilateral protocol of 2006 being as large as 800 pages.

26. By contrast, China retained important restrictions on foreign ownership during its accession to the WTO. China allowed foreign ownership in different telecommunication services (value added and paging, mobile and data services, and domestic and international wired service) to rise to a limit of 50 percent after a short phaseout period (Lardy 2002).

4

Impact of WTO Accession on the Russian Economy

A curious aspect of Russia's WTO accession is how long it has taken. A main reason is that it is actually more difficult for large and complex economies to enter the WTO because they raise more concerns among their trading partners. Moreover, for many years the Russian leadership did not appreciate the significance of the WTO, and Russia's interest has varied with the direction of the political winds at home. The potential impact on the Russian economy, however, is only becoming greater as the WTO gains importance for Russia's economic modernization.

History of Russia's WTO Application

In June 1993, Russia applied to join the General Agreement on Tariffs and Trade (GATT).[1] The GATT Working Party on Russia's accession was formed, and it gradually expanded to more than 60 WTO members, each of which could require a separate bilateral market access agreement with Russia. On average, it has taken six years for a country to accede to the GATT/WTO, but it has been much easier for small countries than for large ones that arouse many trade interests. China needed 15 years, Vietnam 11 years, and Saudi Arabia 12 years, but Russia takes the prize.

In 1994, Russia submitted its formal Memorandum on the Foreign Trade Regime to the GATT. In December 1995, its application to the GATT was renewed for membership in the newly formed World Trade Organization. For the next five years, Russia proceeded with purely bureaucratic procedures without any real progress on substance. During 1995–97, Russia's negotiators had to answer 3,500 questions about its trade system from WTO members. Russia submitted its initial goods market access offer in February 1998 its initial services market access offer in October 1999. The Working Party met regularly twice a year with little progress until 2000.

1. See Åslund (2003, 2010) and Bush (2006).

In 2000, Russia's policy toward the WTO changed. Vladimir Putin became president, and he made Russia's early entry into the WTO one of the priorities in the sweeping economic reform program orchestrated by his chief reformer, Minister of Economic Development and Trade Herman Gref. Russia's awakening was partly due to new leadership and intellectual maturity, but the decisive cause appears to have been China's accession to the WTO in 2000. Putin set the end of 2003 as the goal for Russia's accession—that is, the end of his first term.

WTO accession became one of the major themes in the extensive institutional reforms that President Putin pushed through parliament between 2000 and 2003. Important laws were adopted during this period, including a Tax Code in installments, a Civil Code, and a new Customs Code (coming into force in January 2004). By late 2003, Russian legislation had largely been brought into conformity with WTO standards, with a few sensitive exceptions. In 2002, both the United States and the European Union declared Russia a market economy, while neither has recognized China as a market economy as yet.

Meanwhile, domestic Russian lobbies increasingly opposed aspects of opening Russian markets to foreign competition. The main lobbies critical of WTO accession were agriculture, automotive and aircraft industry, and financial services. By contrast, Russian steel producers, who desired more secure market access abroad, were the foremost protagonists.

Yet, in spite of full support from the Russian parliament and the world as a whole, Putin failed to meet the deadline he had set for himself. He became frustrated, and in his second term Putin gradually lost interest in the WTO. The bureaucratic process ground on. In May 2004, the European Union signed its bilateral protocol on market access with Russia. Finally, in November 2006, the United States signed its bilateral protocol of 800 pages on market access with Russia, but at about the same time President Putin stopped showing any public interest in the WTO.

In May 2008, Dmitri Medvedev was inaugurated as Russia's president, and like his predecessor eight years earlier, he made Russia's accession to the WTO one of his priorities. Russia's advanced negotiations on WTO accession started anew. In August 2008, however, Russia and Georgia engaged in a brief war, which aggravated Russia's international relations, not least with the United States. Things became even more complicated in June 2009, when Prime Minister Putin threw the WTO negotiations into disarray by claiming that Russia would apply for WTO membership as a Customs Union together with Kazakhstan and Belarus. Later, however, the three countries agreed to continue to apply individually, but it took one year to eliminate this blockage. In July 2010, Russia, Kazakhstan, and Belarus adopted a new common Customs Code within the framework of their Customs Union, but that did not bar Russia's WTO accession.

In June 2010, Presidents Barack Obama and Dmitri Medvedev announced their intention to settle outstanding bilateral issues related to Russia's WTO

accession by September 30, 2010. Russian WTO accession gained more momentum than ever. Following the September 30 deadline set in June, President Obama acknowledged recent steps taken by Russia to meet its WTO commitments. He pledged US support for the completion of multilateral talks in Geneva, and US Trade Representative Ron Kirk emphasized the importance of continued engagement with Russia on outstanding issues, including on regulations for the import of goods with encrypted technology, enforcement of intellectual property rights, and agricultural trade, including sanitary and phytosanitary matters. In December 2010, Russia and the European Union agreed on two key questions, reduction of Russian export tariffs on lumber and elimination of Russian discriminatory railway fees.

At this stage, very few tasks remain. The politically most complex is that Russia needs to conclude a bilateral protocol on market access with one more country, Georgia, which demands that Russia recognize its borders in Abkhazia and South Ossetia. Ukraine acceded to the WTO on May 16, 2008, but has not requested a bilateral protocol. Multilateral issues that are still outstanding are domestic agricultural subsidies, and sanitary rules and inspection protocols. Additionally, the text of the Working Party Report on Russia's accession must be modified to reflect the rules of Russia's Customs Union with Kazakhstan and Belarus. However, negotiations on the important multilateral memorandum for the conditions for Russia's accession to the WTO are well advanced, and most of these items could be resolved within months.

Effects on the Russian Economy

Several studies have examined the effects of WTO entry on the Russian economy, mainly sponsored by the World Bank and the Russian Ministry of Economic Development. Their purpose has been to enlighten Russian policymakers and citizens on the consequences of WTO accession.

The World Bank studies are probably the most authoritative. We summarize their conclusions below.[2] In the medium term, welfare gains to Russia from WTO accession will equal 7.8 percent of Russian consumption (and 4.3 percent of Russian GDP); in the long run, after the investment climate has improved, gains could be as high as 24 percent of Russian consumption (and 11 percent of GDP). These gains come from

- liberalization of barriers to foreign direct investment (FDI) in service sectors;
- improved resource allocation as a result of Russian tariff reduction; and
- greater access for Russian products in foreign markets.

2. The World Bank studies in question are Jensen, Rutherford, and Tarr (2004a, 2004b, 2004c), Rutherford, Tarr, and Shepotylo (2004, 2005), and Rutherford and Tarr (2006, 2010).

The most significant effect (about 85 percent of the total medium-term welfare gains) will come from liberalization of barriers to FDI in business services. Tariff reductions and consequent resource allocation will account for about 9 percent of the welfare gain, while improved market access accounts for about 5 percent (see table 4.1).

Julian Cooper (2006a, 2006b) has investigated Russia's competitiveness using an index of revealed comparative advantage, defined as a country's share of world exports of a particular good divided by its share of total world exports. The higher the ratio, the stronger the country's comparative advantage in that particular product. Russia's revealed comparative advantage is overwhelmingly in hydrocarbons, other crude materials, and chemicals, predominantly at a low level of processing. These products are energy intensive, benefiting from Russia's low energy prices. By contrast, manufactured goods are distinct fields of revealed comparative disadvantage. Out of 70 product groups in which Russia is competitive, only four cover machinery and transportation equipment. These four include nuclear reactors, condensers for steam boilers, rail freight wagons, and steam turbines. These goods are traditional Soviet products, now being exported by Russia to old captive markets in the former Soviet Union.

So far there is no sign that Russia is breaking into new manufactured export markets of significance, either in terms of products or destinations. Accordingly, Russia is not likely to evoke protectionist concerns in the United States, standing in stark contrast to China. The only two Russian product groups that have sparked trade disputes in the past are ferrous metals and mineral fertilizers, but two of the biggest steel producers in the United States, Severstal and Evraz Holding, are now Russian-owned companies. Similarly, Russian purchases of American enterprises, largely in metallurgy, have hardly aroused any concern, while attempted Chinese enterprise purchases in the United States have been halted because of national security concerns.

One shortcoming with forecasts based on revealed comparative advantage analysis is that they make no allowance for change. Industries that are strong today are projected to be strong tomorrow; industries that are weak today are projected to be weak tomorrow. Hence, projections based on revealed comparative advantage suggest that the Russian manufacturing sectors most likely to expand as a result of WTO accession are metals (ferrous and nonferrous) and chemicals. By contrast, manufacturing sectors most likely to decline are machinery and equipment, food processing, light industries, and construction materials.

However, WTO accession will have far reaching implications for the Russian economy, and inferences based on current trade patterns may not capture dynamic changes. An alternative approach uses so-called gravity model equations to suggest what would happen to Russian commerce if it followed general patterns of trade (see appendix A).

The US International Trade Commission (USITC 2006), for example, uses disaggregated gravity model equations (based on Russian exports as of 2003)

Table 4.1 Impact of WTO accession: Decomposition of effects in the medium term

Impact on	Total impact	Component		
		Removal of Russian barriers to foreign direct investment	Tariff reduction in Russia	Improved market access for Russian exporters
Aggregate welfare				
GDP increase (percent)	4.3	3.7	0.4	0.2
Aggregate trade (percent change)				
Real exchange rate[a]	2.5	1.1	2.0	−0.6
Aggregate exports	9.4	2.9	5.5	0.6
Returns to mobile factors (percent change)				
Unskilled labor	4.1	3.3	1.2	−0.3
Skilled labor	4.2	2.1	2.0	0.0
Capital	4.0	2.1	1.7	0.2

a. Results are the percent change from the base year.

Source: Rutherford et al. (2010).

to identify destinations and sectors where Russian exports are below what might be predicted from world norms. The authors conclude that, even excluding energy trade flows, current Russian exports to its "close" neighbors (i.e., Ukraine, Eastern Europe, Turkey, and Kazakhstan), the European Union (15 members), Iran, and India are very strong and often above export flows predicted by the model. By contrast, exports to China, Japan, Korea, and the United States are lower than expected by the model, indicating untapped trade potential.

With regard to Russian exports to the United States, the USITC gravity model concludes that Russian exports to the United States of base metal and petroleum products (excluding crude petroleum, which is not considered in the model) are in line with model predictions given the characteristics of Russia and the United States (e.g., distance, size, and language). By contrast, the model identifies chemicals and transportation equipment as the two areas where the performance of Russian exporters in the US market is particularly poor. Machinery and equipment, electronic equipment, precision instruments, and wood products are also areas where the performance of Russian exporters is below predicted values based on gravity model coefficients. These weaker sectors may hold the highest export potential for Russia in the US market. However, revealed comparative advantage analysis indicates that Russian producers of advanced manufactures have a long way to go before they can aspire to become global players.

Even though Russian producers may enter new export lines in the wake of WTO accession, a "China story" seems most unlikely. The "China story" largely reflected "efficiency-seeking" FDI entering the Chinese manufacturing sector in search of low wages, decent infrastructure, and a stable institutional setting. By contrast, "efficiency-seeking" FDI to Russia has so far been very limited. Russian wages are not particularly low, and institutions are weak. Instead, "resource-seeking" foreign investment, centered on the energy sector, has dominated the Russian FDI picture. Additionally, automotive and consumer goods companies are investing in Russia in order to enhance their sales, involving imports from the United States of both parts and finished products. As discussed in chapter 2, import patterns of the Russian economy are very different from those of the Chinese economy, with a marked preference for consumer products rather than industrial inputs (table 2.4).

Overall, the impact of WTO accession on Russia's economy would be sizeable, while the economic gains to the international community would be spread over many trading partners. Qualitatively, however, WTO accession could be a game-changer both for Russia and its international partners. With more FDI, services trade, and diversification, Russia will be more deeply integrated into the global economy, and natural resources will be less dominant, rendering Russia a more normal economy and polity (Tarr and Volchkova 2010).

5

Conclusion

Russia's commitment to join the World Trade Organization remains firm. In an earlier statement, Russia's president, Dmitri Medvedev, emphasized this point:

> Russia's accession to the WTO is not about following the fashion but is a step we must take. We have spent much time and effort on this. . . . I hope that this process will soon be completed. I have said on past occasions that we do not seek WTO membership at any price. For all our respect for this international institution it is a means of achieving our aims and not an aim into itself. But it is a means that we must have at our disposal in order to be able to speak a common language and put ourselves on a level playing field with our partners.[1]

WTO accession negotiations have resulted in numerous concessions by Russia of great importance to the United States, the international community, and to Russia itself. Following accession, Russia is more likely to embark on the path of reform and improve business conditions for US and other foreign business firms. WTO accession thus provides a stepping stone for the United States and Russia to realize the overdue potential of their bilateral economic relations. However, Russia's membership in the WTO does not mean that the United States will automatically qualify for the concessions granted by Russia during its accession negotiations. Instead, considerations of reciprocity will tie many of these benefits to the decision by the US Congress to grant permanent normal trade relations (PNTR) to Russia.

The law that provides the backdrop for the PNTR debate, the Jackson-Vanik Amendment, is a relic of a distant past that does not set the right tone for US-Russia economic relations in the 21st century. Russia no longer restricts emigration, and the penalties associated with Jackson-Vanik—namely the imposition of Smoot-Hawley tariffs—are simply too draconian to be applied. Meanwhile, the amendment stands in the way of concrete economic benefits for the United States. Without PNTR, US firms and workers will be put at a distinct competitive disadvantage in the Russian market.

1. "Responses to Questions from German Political, Parliamentary and Civic Leaders," June 5, 2008, www.kremlin.ru (accessed on June 12, 2008).

The Russian economy is growing fast and already belongs to the world's top ten economies. The rapid rise of the Russian economy is creating vast opportunities for foreign producers, both in trade and investment, and global firms are responding accordingly. Russian imports, exports, and inward foreign investment have all quadrupled over the past six years between 2002 and 2008. Russia is too high a prize for the United States to ignore.

Russia also ranks among the wealthiest emerging-market countries. Russia's relatively high income has created a large number of sophisticated consumers, making an attractive market for US producers. This market already exists and will only grow larger in the future. Russia's accession to the WTO and a favorable PNTR decision could bring many concrete benefits for the US economy:

- Agricultural exports could more than double within just a few years. Gains would result not just from improved access for US meats but also from a sharp increase in US exports of foods and beverages that today are marginally present in the Russian market (e.g., wine, temperate fruits, and tree nuts).
- A doubling of manufactured exports is well within reach, driven by the stronger performance of US pharmaceutical and aircraft exports and accompanied by important sectors such as transportation equipment and machinery. US manufactured exports will be boosted not just by the increased market access but also by higher US foreign direct investment (FDI) in Russia.
- The greatest effects are expected in the services sector, which has been strictly protected by formal and informal barriers. WTO accession talks have already resulted in increased market access commitments for telecommunications, finance, and insurance, which are all of prime interest to US service providers. Given US competitiveness in services, Russia's WTO accession will lead to a larger commercial presence of US service providers through FDI, as Russia agrees to loosen its ownership caps in these sectors.

Appendix A

Gravity Model Assessment of the Impact of WTO Accession on Russian Trade

To assess the quantitative impact of WTO accession on Russian trade, we draw on estimates for merchandise trade between industrial countries derived from the Peterson Institute gravity model, many of whose explanatory variables have their origin in an augmented version of the Rose (2004) gravity model. The basic Peterson Institute model (following Rose) evaluates two-way bilateral trade flows, measured in a common currency (and adjusted for inflation), against the gravitational "mass" of explanatory variables describing the characteristics of bilateral trading partners.[1] Two fundamental variables are distance and joint real GDP. In general, gravity models find that two-way trade between countries is significantly greater, the larger the combined GDP and the shorter the distance between them. Additional explanatory variables show how much two-way bilateral trade expands or contracts from the quantity predicted by the basic core variables on account of institutional or policy features of the partners. For instance, trading partners that share a common language, a common currency, or belong to the same regional trading arrangement typically enjoy greater mutual trade.

Following Rose (2004), the model additionally includes GATT/WTO membership by one or both trading partners as an institutional factor in the model, with the expectation that membership will enhance bilateral trade. The rationale is straightforward: Accession to the GATT/WTO provides reciprocal most favored nation (MFN) status to both members and hence better trade opportunities.[2] Contrary to his expectation, Rose (2004) found little appreciable

This appendix was principally authored by Dean DeRosa.

1. Among other recent applications of the Peterson Institute gravity model, see DeRosa (2009).

2. Beyond direct enhancement of trading opportunities, reciprocal MFN policies imply a degree of own-country trade liberalization and therefore indirect enhancement of export competitiveness and performance through more efficient allocation of domestic resources.

impact on trade from the inclusion of two simple GATT/WTO indicator variables. One indicator variable takes a unitary value if both trading partners are members of the GATT/WTO, and zero otherwise. The other indicator variable takes a unitary value if only one trading partner is a member of the GATT/WTO, and zero otherwise.

Rose's findings stimulated considerable controversy in trade policy circles, as summarized by Rose himself (2006). Recent investigators have, for instance, emphasized the importance of so-called country fixed effects and the differential experiences of industrial countries versus less developed countries. The latest studies also stress the creation of bilateral trade by new GATT/WTO members where no trade previously existed. The variant of the Rose model employed here focuses on aggregate merchandise trade between countries at the 1-digit Standard International Trade Classification (SITC) level over the period 1976–2005 and takes into account the influence of inward foreign direct investment stocks (FDI stocks) on the magnitude of bilateral trade flows.

Table A.1 presents estimation results both for all nonfuel merchandise trade (SITC 0 through 8, less SITC 3) and for manufactures trade (SITC 5 through 8) of industrial countries with all their trading partners.[3] Manufactures are widely held to be the most appropriate trade category for estimation by gravity models because intra-industry commerce flourishes when trade barriers are low. Moreover, tariffs on manufactures have historically been the prime object of multilateral trade liberalization under GATT/WTO auspices.

The estimation results in table A.1 indicate that the gravity model explains a substantial proportion of trade for both trade aggregates. Indeed the R-squared value for both sets of estimation results is 0.96.[4] Moreover, the coefficient estimates in table A.1 for traditional gravity model explanatory variables, such as joint GDP and distance between trading partners, bear the anticipated signs and are highly significant—particular hallmarks of gravity models.

Our main interest, however, is to estimate the increase in Russian trade with the world that would result from membership in the WTO and an expansion of inward FDI. To make these calculations, we focus on the coefficient estimates for the GATT/WTO and FDI variables, the explanatory variables specially included to discern the potential impact of WTO accession on Russia's trade. For this purpose, we assume that once Russia joins the WTO, Russian trade will follow the pattern of other industrial countries.

3. Following Rose (2004), we use the International Monetary Fund's list of industrial countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, South Africa, Spain, Sweden, Switzerland, Turkey, United States, and United Kingdom.

4. Some caution should be exercised in interpreting the very high R-squared value for both estimation results. The statistic may be inflated by the Plumper and Troeger (2007) multistage estimation, which measures the statistic only in the last stage of the procedure.

Table A.1 Estimates for nonfuel and manufactures trade by industrial countries with all partners, with WTO membership and foreign direct investment explanatory variables, 1976–2005

Explanatory variable	Nonfuel commodities and manufactures (SITC 0 to 8, less SITC 3)	Manufactures (SITC 5 to 8)
Both in GATT/WTO	0.16***	0.16***
One in GATT/WTO	0.15***	0.14***
Joint FDI (inward stock)	0.08***	0.08***
Distance	−0.83***	−1.03***
Joint GDP	1.04***	1.14***
Currency union	0.04**	−0.03
GSP	0.29***	0.49***
Regional FTAs	0.17***	0.18***
Common language	0.36***	0.43***
Common border	0.21***	−0.01
Landlocked	−0.14***	0.00
Island	0.30***	0.29***
Joint land area	−0.14***	−0.18***
Colony now	0.31***	0.37***
Ever a colony	0.75***	0.62***
Constant	−34.85***	−38.07***
R-squared	0.96	0.96
Observations (thousands)	34	34
Groups (thousands)	3	3

GSP = Generalized System of Preferences
FTAs = free trade agreements
SITC = Standard International Trade Classification

Sources and notes: Fixed-effects estimates obtained by a multi-step method developed by Plumper and Troeger (2007). Dependent variables are bilateral trade and bilateral inward FDI stocks, both measured in log real terms. Distance, joint real GDP, joint land area, and joint real inward FDI stocks are measured in log terms. Estimates for year effects are not reported. *,**,*** denote statistical signficance at the 10, 5, and 1 percent levels, respectively. Clusters are the number of ordered country pairs in the panel dataset.

The coefficients of both the GATT/WTO variables and the FDI inward stock variable are positive and significant. Whereas Rose's estimates for the coefficient when both partners are members of the GATT/WTO were frequently negative, the present coefficient estimates for this variable in table A.1 are positive and identical in value, 0.16, for both trade aggregates.[5] This coefficient

5. However, when the same trade data are disaggregated (and pooled) by 1-digit SITC categories, the gravity model frequently finds coefficient estimates for the two GATT/WTO variables that are negative but not statistically significant.

value implies that WTO accession would raise Russian bilateral trade in nonfuel commodities and manufactures by nearly 20 percent. In dollar terms, total Russian two-way trade in manufactures was $186 billion in 2009, and total bilateral manufactures trade with the United States was $10 billion. Based on the estimated coefficient, these figures could expand to $223 billion and $12 billion, respectively, following Russian accession to the WTO.[6]

It is worth noting that the joint FDI stock variable has an estimated coefficient of 0.08 both for all no-fuel trade and for manufactures trade. This coefficient estimate implies that a 50 percent increase in Russia's inward FDI stock from the current level of about $200 billion to $300 billion—a plausible consequence of WTO membership and greater normalization of the Russian economy—would trigger an increase in total Russian two-way trade in manufactures trade of about 5 percent, or some $9.3 billion. The associated increase in bilateral manufactures trade with the United States would be $0.5 billion, assuming that the United States enjoys only a proportional increase in two-way trade.

The foregoing calculations reflect an orthodox application of gravity model analysis, confined, as mentioned, to Russia's merchandise trade with the world. We believe the results, while orthodox, do not reflect the potential growth in US trade with Russia, especially since US export levels are low compared with the size of Russian GDP and the export experience of other countries that sell into the Russian market.

The calculations we offer in the main text and summarize in the next paragraph are more speculative but, in our opinion, better reflect the potential of US-Russian trade within the framework of normal WTO rules. These alternative calculations are based on the supposition that the so-called fixed effects coefficient that uniquely characterizes US-Russian export relations is zero, rather than the negative value found in gravity model analysis.[7]

Following this approach, it appears the potential total US exports to Russia are 2.8 times the size of actual US exports to Russia.[8] Since actual US

6. The percentage trade expansion is derived from the estimated coefficient for the both-in GATT/WTO variable. Given the log-linear specification of the gravity model regression equation, the impact of WTO accession on bilateral trade is computed in percentage terms as $100*[exp(b) - 1.00]$. In this expression, b is the estimated coefficient for the both-in GATT/WTO indicator variable, and $exp(b)$ is the value of the natural number e raised to the exponent b. For example, if the coefficient b is 0.33, then the value of $exp(b)$ is 1.39, and the percentage expansion in trade is estimated as $100*[1.39 - 1.00]$, which equals 39 percent. Notably, this calculation assumes that the trading partner of the new WTO member is also a WTO member. According to the estimation results in table A.1, however, the trade impacts of Russian accession to the WTO cited in the main text would be only slightly lower in value if one of its trading partners was not a WTO member, because the coefficient estimates for the one-in GATT/WTO variable are only somewhat lower in value.

7. See the technical explanation in DeRosa (2011, forthcoming).

8. For US exports of manufactures to Russia, US potential trade is 2.2 times greater than the recorded size of US shipments to Russia.

exports to Russia in the last "normal" trade year before the great recession, namely 2008, were $9.3 billion, it appears that potential US exports could be as much as $26 billion. We think this figure, a near-tripling of total US exports to Russia, better represents the potential growth of trade within the WTO framework than the orthodox gravity model analysis. Conservatively, in the main text, we refer to the prospect of doubling US-Russian trade in the wake of WTO accession and PNTR.

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